

Tax treaty interpretation

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**TAX
TREATY
INTERPRETATION**

A Ph. D. thesis submitted by

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Abstract of *Tax Treaty Interpretation*, a Ph.D. thesis by Michael Edwardes-Ker

This thesis analyses which principles should govern the interpretation of tax treaties. This field is complex – because tax treaties have a dual status.

Tax treaties are *treaties* between States – which are governed by public international law, the principles of which have been codified in the 1980 Vienna Convention on the Law of Treaties.

Tax treaties are also *laws* which can affect the domestic rights of taxpayers (and States).

Different, and possibly conflicting, principles of interpretation may apply in public international, and in (different) domestic, contexts.

This thesis seeks to reconcile these different principles, recognising that tax treaties should be interpreted uniformly. Only if this is done can double taxation (and double non-taxation) be avoided – and reciprocity achieved.

This thesis analyses *why*, and *when*, the Vienna Convention is relevant in interpreting a tax treaty in a domestic context. It seeks to describe a uniform approach to tax treaty interpretation – which could be applied by domestic courts worldwide.

It reaches four main conclusions.

Firstly, a textual approach (endorsed as the starting point of interpretation at a public international level by Article 31(1) of the Vienna Convention) should (also) be the starting point of interpretation in a domestic context.

Secondly, the proper approach in a domestic context cannot be the mirror image of the Vienna Convention approach.

Thirdly, a uniform domestic approach cannot be identical to any one particular State's approach to the interpretation of its domestic tax statutes.

Fourthly, a uniform domestic approach should be autonomous – and neutral as between all States. It should recognise a tax treaty's dual status – yet be independent of any interpretative principles which are appropriate only in a purely public international, or a purely domestic, context.

INTRODUCTION

To ensure consistency, and to facilitate further research, all the material in *Tax Treaty Interpretation* uses the same citations as *The International Tax Treaties Service*. To ensure that *Tax Treaty Interpretation* can be used independently, on a “stand-alone” basis, full citations are given in Appendix III. A list of headings follows.

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Part I *Tax treaty interpretation; the need for a harmonised approach*

Chapter 1 Introduction; the dual status of tax treaties

1.01 *Introduction; the dual status of tax treaties*

TAX TREATY INTERPRETATION is a thesis submitted by Michael Edwardes-Ker for a Ph.D. degree at Queen Mary and Westfield College, London University. The copyright of this thesis rests with the author and no quotation from it or information derived from it may be published without the prior written consent of the author.

Tax Treaty Interpretation, a companion publication to *The International Tax Treaties Service* (see Chapter 1.06), analyses the basic principles which should govern the interpretation of tax treaties. These principles are made more complex by the fact that tax treaties have a dual status; they are *treaties* between States and *laws* which can affect the domestic rights of taxpayers (and States). Let me elaborate.

A tax treaty is a treaty between two (or more) States. Treaties between States are governed by public international law. Therefore, *as between the treaty partner States themselves*, the interpretation of a tax treaty is governed by public international law. The principles of public international law applicable to treaties, and their interpretation, have been codified in the 1980 Vienna Convention on the Law of Treaties – see Chapter 4.

However, tax treaties are also incorporated into domestic law – with taxpayers acquiring rights and obligations vis-à-vis States (and vice versa). As between taxpayer and State, the interpretation of a tax treaty by a domestic court is governed by that State's domestic law.

Different, and possibly conflicting, principles of interpretation may apply at a public international level and at (different States') domestic levels.

1.02 *The interpretation of tax treaties at public international and EU levels*

Consistency demands that, to the extent possible, the approach to (tax) treaty interpretation applicable at an international level should also apply at a domestic level.

Hitherto, there has been little recognition of the need for an approach which seeks to reconcile the different approaches to tax treaty interpretation applicable at a public international level and at (different States') domestic levels.

Those specialising in public international law have hardly focused on tax treaties – which have typically only been adjudicated upon by domestic courts. For example, I have been unable to find a single specific reference to tax treaties in either Brownlie (1990), or Greig (1976), or O'Connell (1970) or Shaw (1991) or Sinclair (1984).

Similarly, no-one specialising in tax has, until recently, focused in-depth on which (if any) of the principles of treaty interpretation applicable at a public international level should govern the interpretation of tax treaties at a domestic level. As Ward, one of the few tax lawyers to focus on principles of international law, commented (1985, 394): "How unfortunate it is ... that lawyers who specialize in international law seem to shun

cases involving the interpretation of tax treaties, while lawyers who deal with tax treaties seem to be unaware of the principles of international law.” As tax treaties multiply, this lack of focus is likely to disappear – as forecast by Duval (1991, 1244).

A major reason for this lack of focus is that, in recent years, tax treaty disputes solely between States themselves have not been adjudicated upon at a public international level. However, such international adjudication is likely in the next few years (see Chapter 2.04 onwards), notably in an EU (European Union) context – where supranational adjudication is now more than a taxpayer’s dream.

The likelihood of increasing international (and supranational) adjudication highlights the urgent need for an approach to tax treaty interpretation which recognises, and seeks to reconcile, the differing principles of law applicable at a public international level and at a domestic level in different States. Ideally, such a reasoned approach would be neutral as between States – so that it could be applied consistently and uniformly by different States.

1.03 *The interpretation of tax treaties at a domestic level*

Because tax treaties can be interpreted at (a minimum of) two levels – a public international (State) level and a domestic level – they have a dual status.

However, domestic courts have rarely focused explicitly on a tax treaty’s unusual dual status – as a *treaty* between two States, and as *domestic law* which must be applied between taxpayers and States. Accordingly, inconsistencies in interpretation have arisen. Even in a single State, it is often difficult to discern a consistent interpretative approach. For example, Germany: *January 20 1993 BFH* conflicts squarely with Germany: *October 9 1985 BFH* (both Article 7 and see Chapter 11.03).

More generally, as regards Canada, Boidman has commented (1980, 388): “The result is an unpredictable mix between the use of purely domestic rules of interpretation in some cases and a blend of domestic and treaty rules in other cases, making it difficult to foresee the resolution of a future treaty issue.” Similarly, as regards four contemporary UK judgments, Williams has commented (1990, 302): “... it is easier to spot the inconsistencies between their approaches than the common ground.”

When the approaches of domestic courts in different States are compared, even greater inconsistencies become evident. As Schreuer commented (1971, 264 Footnote 4 omitted) over two decades ago in relation to treaties generally: “The tendency of national courts to apply the concepts and methods of their own municipal law is probably one of the most important causes of this divergence. Consciously or unconsciously they tend to follow their own precedents and doctrines even in cases where they have to interpret and apply law which does not originate in their domestic legal systems: a tendency which is naturally more marked in common law countries.”

To what extent should domestic courts apply principles of public international law? To what extent should domestic courts apply EU (or other regional) principles? To what extent should each State apply its own (possibly unique) domestic principles of

interpretation? Should a tax treaty be interpreted as an agreement (or contract) between two States – or should it be interpreted as a domestic statute (which, in many common law jurisdictions, it will be)?

Domestic courts have long realised that domestic maxims and principles of interpretation, however suitable they may be in interpreting domestic tax legislation, may be less than appropriate in interpreting a tax treaty. They recognise, in Prebble's phrase (1993, 468), that tax treaties are to some extent "diplomatic, rather than legalistic, documents".

There are other differences between tax treaties and domestic fiscal legislation. Firstly, a tax treaty's primary aim is to avoid double taxation – whilst domestic tax legislation will typically seek to impose tax in specific circumstances. As US: LR 78–44–008 (Article 7 and see Chapter 10.05) notes: "A treaty attempts to state certain broad principles upon which the contracting parties agree ... The Code, on the other hand, attempts to anticipate and deal with specific problems." Secondly, tax treaties will typically contain what Mitchell B. Carroll described (1935, 588) as "international tax language" (see Chapter 7.02), based on a standard model – whilst domestic tax legislation will typically contain highly technical language, debated at length prior to enactment. Thirdly, any relevant intentions (see Chapter 6) in interpreting tax treaties will be those of two (or more) contracting States (see Chapter 5) – whilst in interpreting domestic tax legislation, only the intention of a single Legislature will be relevant.

Accordingly, domestic judges have often modified their domestic interpretative approach when dealing with tax treaties.

Until recently, these modified domestic approaches rarely focused on the relevance of any principles of public international law – despite the fact that a tax treaty is a treaty between States. Unfortunately, even those judges who have recently focused on the applicability of the Vienna Convention have done little more than cite it. Just as unfortunately, some of those judges who have focused on principles of public international law have applied them with an insensitivity as inappropriate as their colleagues' lack of focus.

No judge has yet explicitly held that whilst some principles of public international law should be applied at a domestic level, others should only be applied, if at all, in a domesticated form – which takes due account of the fact that a tax treaty involves the (domestic) rights of taxpayers as well as the (public international) rights of States. This may be because, until now, no commentator has reached this fundamental conclusion – which is elaborated on below and, notably, in Chapters 15 - 17, 21, 26 and 27.

1.04 *A uniform, reasoned, approach to tax treaty interpretation at a domestic level*

Effectiveness and reciprocity (see Chapter 12) demand that tax treaties be interpreted uniformly by treaty partner States. Only if this is done can double taxation (and, possibly, double non-taxation) be avoided. The desirability of a common interpretation has long been recognised; it is the *raison d'être* of the OECD and UN Commentaries on

their Models (see Chapter 23.24).

Because tax treaties are treaties, a uniform approach to tax treaty interpretation must take account of principles of public international law, as now embodied in the Vienna Convention of the Law of Treaties.

Many States' domestic courts (including those in Australia, Canada, Germany, New Zealand, Switzerland and the UK) have already held that, when they interpret a tax treaty, they should follow the Vienna Convention's approach to treaty interpretation – see Chapter 3.03 onwards. Although there is no reason why public international law should have become more relevant to tax treaty interpretation after its codification in the Vienna Convention than before, this growing awareness of its relevance is welcome. Implicit in such awareness is the recognition that, to the extent possible, a tax treaty should be interpreted consistently at a public international level and at a domestic level by domestic courts worldwide.

However, other States' domestic courts have yet to acknowledge the Vienna Convention's relevance to tax treaty interpretation. As an extreme example, no US court interpreting a tax treaty has yet acknowledged this Convention's existence. No doubt this is because the US has not ratified this Convention (see Chapter 4) – but such non-ratification itself demonstrates the existence of divergent approaches.

Accordingly, when they interpret a tax treaty, some States follow the Vienna Convention's approach more closely than others. A quartet of German, UK and US decisions (*October 9 1985 BFH*, *January 20 1993 BFH*, February 9 1990 *Commerzbank* and May 5 1982 *Great-West* respectively – all Article 7 and see Chapter 6.05 onwards) are the most notable examples of courts in different States adopting divergent approaches to the interpretation of similar tax treaty language.

It is not coincidental that the similar conclusions in *October 9 1985 BFH* and *Commerzbank* (which both considered the Vienna Convention) conflict with the similar conclusions reached in *January 20 1993 BFH* and *Great-West* (which did not even cite the Vienna Convention). Indeed, *Great-West* adopted an approach that was plainly inconsistent with the Vienna Convention – see Chapters 6.06 and 6.07.

When the same treaty words are interpreted differently in different States, it is worth analysing which State is applying the Vienna Convention's principles most faithfully. Such an analysis by reference to a single set of principles may lead courts to amend their different approaches – so as to conform more closely to an internationally acceptable approach. The more uniform and consistent each State's approach is, the greater the likelihood of tax treaty terms being given a uniform and universal meaning.

These divergent attitudes to the Vienna Convention reflect differences in domestic interpretative approaches which have been apparent for years. The sooner such differences are recognised, the sooner attention will focus on the need to achieve a uniform, approach to tax treaty interpretation in all States. As Avery Jones has commented (1991, 37): "What is required is that all countries use the same approach to the interpretation of tax treaties ..."

The proposition that all domestic courts should adopt a uniform approach to tax

treaty interpretation, founded on principles of public international law, has obvious attractions. But is this proposition feasible in practice – and, if so, what changes are required?

1.05 *Conclusions; an autonomous approach must evolve*

The material below analyses *why*, and *when*, the Vienna Convention is relevant in interpreting a tax treaty at a domestic level. It seeks to describe a reasoned, neutral approach to tax treaty interpretation – which could be applied uniformly by all domestic courts and tax authorities worldwide.

Because public international lawyers have hardly focused on tax treaties, and because tax specialists have not focused in-depth on principles of public international law, some of my conclusions are, perforce, original – and, possibly, extreme. They may also reflect my own *déformation professionnelle* – which makes it impossible for me to ignore the rights of taxpayers vis-à-vis States. Whenever my conclusions are obviously pro-taxpayer I have, in the interests of impartiality, tried to present opposing views as fairly as possible. I hope I have succeeded – and apologise if I have not.

My first conclusion is that the textual approach, endorsed as the starting point of interpretation at a public international level by Article 31(1) of the Vienna Convention, should also be the starting point of interpretation at a domestic level.

Over thirty years ago, Lenz (in his General Report on *The interpretation of the double taxation conventions* for the 1960 International Fiscal Association (IFA) Congress) also considered that principles of public international law should form the basis of a domestic approach to tax treaty interpretation.

The second sentence of Lenz's General Report runs (1960, 294): "If the meaning of a treaty provision is not clear then the problem will be solved in the first place by applying the usual rules governing the interpretation of international public law."

Lenz then noted that the IFA Reporters for Germany, Luxembourg and Switzerland had stressed that tax treaties also formed part of domestic law. He concluded (1960, 298): "An agreement is thus simultaneously subject to the rules of interpretation applicable to international and domestic public [*sic*] law, *the rules of public international law taking precedence* in cases of dispute." He continued (1960, 299): "An international agreement must first of all be interpreted in accordance with the rules of international public law."

My second conclusion, however, is that not *all* the rules of public international law should take precedence at a domestic level – where the application of some of them may be quite inappropriate.

My second conclusion, that some principles of public international law should not be applied when a tax treaty is being interpreted at a domestic level, stems from two related premises.

The first premise is that principles of public international law, such as those codified in the Vienna Convention, are (by definition) primarily designed to apply at a public international level – *as between States themselves*.

Embodying this premise, Article 1 of the Vienna Convention runs: “The present Convention applies to treaties between States.” In relation to this Article 1, Para. 13 of the 1989 OECD *Override* Report (see Chapter 23.10 and Appendix I) comments (italics not added): “13. Under the provisions of Article 1, the Vienna Convention has effect only *between States*. The source for rights and obligations for individuals and organs *within a State* is its domestic law.”

In line with the preceding sentence, the second premise is that, as a matter of domestic constitutional law, the rights of taxpayers at a domestic level can only be determined by domestic law – which should only involve the application of public international law when this is constitutionally appropriate. As Greig commented (1976, 54): “... it is not the function of international law to interfere in the application of a state’s own law in accordance with its constitution.”

These two premises do not imply an irreconcilable conflict between public international and domestic systems of law. As Brownlie commented (1990, 35): “The two systems do not come into conflict as systems since they work in different spheres. Each is supreme in its own field.” Neither system has hegemony over the other; each operates at its own level. At each (public international and domestic) level, however, the different systems can lead to different obligations and results.

For example, whilst subsequent practice between States, or their competent authorities, may bind these States *as between themselves*, such practice cannot normally affect the domestic rights of individual taxpayers – because (by definition) it cannot have been incorporated into domestic law. Thus, a State may be bound by its practice *vis-à-vis* another State – but this practice may not be binding *vis-à-vis* taxpayers.

Inherent in my second conclusion is the conclusion that the proper approach at a domestic level cannot be the mirror image of the Vienna Convention approach. A uniform domestic approach should not blindly follow *all* the principles of public international law as if they were inflexible rules – because some of them are only relevant to disputes between the treaty partner States themselves and, for constitutional reasons, should not normally be capable of affecting the rights and obligations of taxpayers at a domestic level.

However, an analysis of the *raison d’être* of the principles applicable at a public international level can clarify which principles should apply at a domestic level. In many cases, the appropriate principles at a domestic level will simply be analogous, domesticated versions of the principles applicable under public international law. Such an analysis can also clarify why it may be appropriate – and consistent – for different results to be reached at different levels.

For example, it is accepted that a State can only be bound (at a public international level) by material of which it could have been aware – see Chapter 21.03. The fact that a State is bound (*vis-à-vis* other States) by material of which it is aware does not mean that this same material should bind (at a domestic level) a taxpayer who could not have been aware of it (see Chapter 21.04) – for precisely the same reasons that a State is not

bound (at a public international level) by material of which it could not have been aware. These different results are consistent – in that they arise through the consistent application (albeit at different levels) of analogous principles. In other words, if the principles of international law are interpreted as adaptable principles, and not as inflexible rules, the appropriate interpretative process becomes much clearer at both public international and domestic levels.

My third conclusion is that a uniform domestic approach cannot be identical to any one particular State's approach to the interpretation of its purely domestic tax statutes – because such approaches do not take sufficient account of the fact that a bilateral tax treaty is a treaty which must be interpreted in accordance with the common understanding of *both* States (see Chapter 5).

My fourth conclusion is that a uniform, reasoned, domestic approach can therefore only be autonomous – and neutral as between all contracting States. It has to recognise a tax treaty's unique dual status – yet be independent of any interpretative principles which are appropriate only in a purely public international, or in a purely domestic, context.

As the analysis below shows, some domestic courts will have to change their approaches to tax treaty interpretation if such an autonomous approach is to evolve – as it must.

For example, domestic courts which have hitherto stressed the “intentions” of the Contracting States will have to adopt a “textual” approach as the starting point of interpretation. This textual approach is endorsed by Article 31(1) of the Vienna Convention and is, effectively, already adopted in several common law States.

Similarly, domestic courts which have hitherto been reluctant to use supplementary means of interpretation, such as *travaux préparatoires*, foreign jurisprudence and doctrine (the commentaries of learned authors) will have to consider such material.

1.06 Sources and methodology

As the Editor of *The International Tax Treaties Service*, I am familiar with the many tax treaty decisions and rulings from all over the world analysed therein. This has enabled me to write *Tax Treaty Interpretation* from a worldwide perspective – and to focus not only on theory, but primarily on practice and on what judges and tax authorities have actually held. This has also enabled me to adopt a consistent method of citation in both publications which has many advantages over traditional methods. Let me explain.

The International Tax Treaties Service was first published in 1977, when it analysed some 550 decisions and rulings from all over the world. From 1977 to date, it has been updated 17 times – an average of once a year. It now consists of over 2500 pages – which analyse over 2000 decisions and rulings from all over the world. The only publication of its kind, it is the most comprehensive single source of the material it aims to analyse.

To facilitate references to this unique source of information, I have evolved a special

method of citation which has been deliberately designed to eliminate confusion, and to facilitate what will be a most useful feature of *The International Tax Treaties Service* and *Tax Treaty Interpretation* – the ability to make electronic (CD-ROM) searches.

Because I anticipate that both these publications will be published electronically on the same CD-ROM, *Tax Treaty Interpretation* has also adopted the method of citation used in *The International Tax Treaties Service*. The adoption of this consistent method means that the reader of *Tax Treaty Interpretation* can easily refer to all the material in *The International Tax Treaties Service*, and vice versa, with ease and efficiency. This feature will be especially useful once this material is available in electronic form. (To facilitate electronic searches, no footnotes appear in either publication. Where footnotes exist in quoted material, they are incorporated into the quotation.)

Under this method, the citation of each decision begins with its date and ends with its (abbreviated) heading. This heading will typically be the first word(s) of the heading of common law decisions or the (abbreviated) court giving non-common law decisions. Thus, the US Tax Court decision of *Georges Simenon, Petitioner, v. CIR, Respondent* is always cited as September 29 1965 *Simenon* and the Netherlands November 24 1982 Hoge Raad decision is always cited as *November 24 1982 HR*. When the same court gives two decisions on the same day, the decision with an earlier reference appears with a /1 after it, and the decision with a later reference appears with a /2 after it.

Because their publication dates may differ, decisions in *Tax Treaty Interpretation* may, very occasionally, bear a date which is later, or earlier, than that in *The International Tax Treaties Service* – and vice versa. This is because one of these publications has taken account of a higher court decision, whilst the other has yet to do so.

All the material in *The International Tax Treaties Service* is published on an Article by Article basis, with each Article corresponding to the 30 Articles in the OECD Models. Material appears in the Article which it is most relevant to, with cross-references in other Articles where necessary. Within each Article, material is analysed alphabetically by State and chronologically within each State. Thus, material on Royalties is analysed in Article 12, beginning with the earliest material from Australia and ending with the latest material from the US.

When a ruling bears a date, it is analysed by reference to this date. A ruling which does not bear a precise date is analysed year-by-year, in numerical order if it bears a number, after all material in this State in this year which does bear a precise date. Notices etc. precede (US) Revenue Rulings – which themselves precede (US) Letter Rulings. This same method is used in *Tax Treaty Interpretation*, as is apparent in Appendix III (and, when published, Appendix IV) – see the next paragraph.

Whenever a decision or ruling is analysed in *The International Tax Treaties Service*, *Tax Treaty Interpretation* contains a reference to the Article in *The International Tax Treaties Service* in which this material is analysed. The full citations for this material are given in Appendix III (Decisions and rulings) or Appendix IV (New Developments). Part or all of Appendix IV will be periodically integrated in to the text

and/or Appendix III and will thus not always be published; for example, no Appendix IV has yet been published. If any decision or ruling cited in *Tax Treaty Interpretation* is not analysed in *The International Tax Treaties Service*, full references are given in the text and in Appendix III (or Appendix IV). Furthermore, whenever either publication cites or quotes material, it always give full references to the original text. Accordingly, although both publications complement each other, they are both “stand alone” publications which are each fully referenced by the same, easy-to-use, method.

Tax Treaty Interpretation also refers to publications and articles by using a comparable citation method; full references are given in Appendix II (Bibliography on tax treaty interpretation).

1.07 Presentation

Tax Treaty Interpretation is presented in Chapter by Chapter form, with each Chapter’s sub-headings being numbered sequentially. Because *Tax Treaty Interpretation* aims to establish the principles which should govern tax treaty interpretation on a worldwide basis, the framework of Chapters 4-30 mirrors the principles of treaty interpretation in Articles 31-33 of the Vienna Convention on the Law of Treaties. The choice of this framework should not be interpreted as an endorsement of the applicability, at a domestic level, of this Convention’s principles – which aim to codify public international law. Rather, this choice was made to facilitate the analysis of which (if any) of these public international principles can apply, worldwide, when tax treaties are being interpreted at a domestic level.

Indeed, the paucity of the material in Chapter 17 (which deals with subsequent practice between States) reflects my conclusion that, because such practice cannot normally have been incorporated into domestic law, it should be given lesser weight at a domestic level than at public international level. Because I conclude that such practice should normally only be regarded as supplementary means of interpretation at a domestic level, I only consider it in detail in Chapter 27.

Chapter 2 The international adjudication of tax treaty disputes

2.01 *Tax treaty litigation at an international level is virtually unknown*

One reason why insufficient attention has been paid to the principles of public international law in a tax treaty context is that no tax treaty litigation at a public international level has been undertaken for several decades.

This paucity is mainly attributable to the fact that there can never be compulsory jurisdiction over a State. A State must agree (possibly in advance) before it can be sued by another State at a public international level.

Article 36(1) of the Statute of the International Court of Justice runs (*italics added*): “1. *The jurisdiction of the Court comprises all cases which the parties refer to it and all matters specially provided for in the Charter of the United Nations or in treaties and conventions in force.*”

Accordingly, one State cannot sue another State in the International Court of Justice – *unless the defendant State agrees to be bound by the jurisdiction of this Court.*

Both the plaintiff State *and* the defendant State therefore have to agree to submit a case to the International Court before it can have jurisdiction. No two States have yet agreed to refer a tax treaty dispute to the International Court – so it has never had the opportunity of applying principles of public international law to a tax treaty.

A further reason why tax treaty litigation at a public international level is virtually unknown is that States can generally agree, as between themselves, how they will interpret a tax treaty.

The impossibility of unilateral recourse to law must induce States to reach agreement – but several non-legal reasons may also induce them to reach agreement.

Firstly, agreement may benefit both States financially – by, for example, curbing tax avoidance or tax treaty “abuse”.

Secondly, the agreements or compromises needed to make a tax treaty work may cover familiar ground. They may differ little from the compromises (horse-trading) which occurred when the treaty was being negotiated. Agreements on the interpretation of an existing tax treaty may indeed form the basis of provisions in a future protocol or successor treaty.

Thirdly, there will normally be no political or emotional impediments to an agreement – the consequences of which will often only be financial. Financial consequences can usually be quantified – making a compromise easier.

Fourthly, mutual agreements may not involve significant sums. Sometimes the actual amount of tax at stake is insignificant; larger sums may be dwarfed into insignificance by the overall economic advantages of having the tax treaty in operation.

Fifthly, litigation is often viewed as a course of last resort – even domestically. Tax treaty litigation between two States would highlight the inability of their officials to agree on the implementation of an agreement which they (or their colleagues) had negotiated in the first place. Imagine the further embarrassment to the losing State (and its officials) of an adverse – and final – ruling.

A sixth reason why there has been no recent tax treaty litigation at a public international level is that post-1945 tax treaties have not, until recently, contained provisions under which differences of interpretation may be referred to international adjudicating bodies. The paucity of such provisions must have discouraged international litigation.

2.02 International tax courts were contemplated originally

Interestingly, the very first tax treaties and models did contemplate that disputes between signatory States should be resolved at a public international level.

Thus, Article 7 of the 1926 Ireland/UK tax treaty ran: “Any question which may arise between the parties to this Agreement as to the interpretation of this Agreement or as to any matter arising out of or incidental to the Agreement shall be determined by such tribunal as may be agreed between them and the determination of such tribunal shall, as between them, be final.”

The first draft tax Conventions prepared in 1928 by the Fiscal Committee of the League of Nations (the 1928 League Drafts – see Chapter 23.03) provided that in the event of two States failing to resolve differences of tax treaty interpretation, the matter could be referred by both of them to a technical body for an advisory opinion, or to arbitration (including a reference to the Permanent Court of International Justice).

The 1934 Czechoslovakia/Romania succession duties tax treaty was more conclusive. It provided that any difference in tax treaty interpretation “... shall be submitted to any technical body that the Fiscal Committee of the League of Nations shall designate to this effect: this body shall formulate an opinion after having heard the parties and, if necessary, after having brought them together: this opinion shall be enforceable and without appeal as regards the contracting States.”

Between World War I and World War II some States did agree to refer differences of tax treaty interpretation to international adjudicating bodies; Chrétien (1951) has listed decisions he was aware of and Albrecht (1953) has listed others. In this period, many commentators considered it self-evident that issues of tax treaty interpretation should be dealt with by some form of international or supranational court – and there was much debate on two related issues.

The first issue was whether tax treaty disputes should be dealt with by a body such as a Fiscal Chamber of the International Court of Justice – or by a separate international or supranational fiscal court.

The second issue, supposedly “subsidiary” but in reality just as important, was whether taxpayers themselves should have access to a supranational court. One deficiency of the international adjudication provisions described above was that they could only be invoked by States – and not by taxpayers.

Rather than grant taxpayers any right to sue at a supranational level, those responsible for redrafting the 1928 League Drafts (i.e., predominantly, tax authorities) decided to take the opposite course. They decided to consolidate the power of resolving tax treaty disputes in the hands of their own States (i.e. in their own hands). States were therefore

to become judges in their own cause.

Accordingly, the 1946 London Model (which superseded the 1928 League Drafts – see Chapter 23.03) provided that differences in tax treaty interpretation were to be settled solely by the competent authorities of the treaty partner States. This effectively disposed of the first issue referred to above (i.e. which court would be most appropriate to adjudicate tax treaty disputes). Access to international courts was to be denied – *even to States* (unless both States agreed otherwise).

The Fiscal Commission of the United Nations, which succeeded the Fiscal Committee of the League of Nations in 1946 (after the 1946 London Model was published) also had to deal with the two issues of whether an international or supranational court should resolve tax treaty disputes, and whether taxpayers should have access to a supranational court.

In 1949 the UN Fiscal Commission commented (Procès-Verbaux of the UN Economic Council, 4th year, 9th session, Supplement No. 2, Report of the Fiscal Commission page 9): “The Commission considers that no specific case has as yet arisen which would justify the study of this proposition, and, in any case, it would be out of order for taxpayers to have the right to come before the court directly if one were created. The Commission believes that each convention should contain provisions providing that the parties will settle between themselves any difference which might arise in the application of the said conventions.”

The UN Fiscal Commission’s hostility to the idea of creating an international court, and its outright refusal to endow taxpayers with rights at a supranational level, can be easily understood. As Chrétien pointed out (1951A, 566) the UN Fiscal Commission, in common with the League’s Fiscal Committee, was largely composed of tax officials from Member States – and national tax authorities wished to reserve to themselves the power to resolve disputes. As a result, for decades to come, the possibility of taxpayers (who have no standing in public international law – see Chapter 16.01) being given a right to compel international or supranational adjudication of tax treaty disputes remained as remote as it would have been welcome.

2.03 *The IFA has long favoured the international adjudication of tax treaty disputes*

Needless to say, most IFA members have not shared the hostility of tax authorities to international/supranational adjudication. At the 1947 IFA Congress, Charles Cardyn was amongst the first to propose the establishment of an international tax tribunal (see Michel 1951, 34 Footnote 2).

For example, the 1951 IFA Congress studied *Judicial interpretation of conventions on double taxation and the necessity or advisability of establishing an international fiscal jurisdiction*. The final resolution (IFA Resolutions 18) “... Recommends the creation, under the auspices of the most qualified international groups, of a permanent juridical committee which would have as its aim to bring to the attention of the Fiscal Committee of the UN the claims presented to them which appear well founded and to inform the interested governments, and the inclusion in multilateral conventions of:

a. where appropriate, a clause envisaging the institution of mixed commissions between the two states to solve certain cases of double taxation;

b. an obligatory arbitration clause permitting the contracting states to have determined by an arbitrator the meaning of the clauses under dispute.

Finally and especially it appears to the Congress as indisputable that it should envisage the institution of a supranational tribunal embodying, in principle, bilateral tribunals. Decisions could be referred to a Supreme Court which would be competent to receive the complaint of any interested person, after exhausting the provision for applying internal legislation. The contracting states would be bound to take all useful measures in order that the recourse to the supranational tribunal will not be too delayed by the slowness of procedure before the national tribunals.”

The fact that this Resolution fell on deaf ears could have come as no surprise to Baumgartner. He had commented (1951, 82) that it was “unimaginable” that States would wish to compromise their fiscal sovereignty by accepting international adjudication, and that there was “not the slightest reason” why they should wish to give taxpayers any standing at a public international level.

Nevertheless, the 1960 IFA Congress on *Interpretation of double taxation conventions: methods and procedures* expressed (IFA Resolutions 88): “5. ... the urgent wish that a study should be made of the possibility of creating in the near future an international fiscal tribunal which will be specially qualified to deal with the difficulties of interpretation of double taxation conventions; ...”

The 1981 IFA Congress studied *Mutual Agreement – procedure and practice*. In a renewed plea for some form of international adjudication, one of its resolutions runs in part (IFA Resolutions 291): “The Congress expressed its particular interest in having countries take as soon as possible the following measures: ...

3. Voluntary or compulsory arrangements should be made for regional or international expert, arbitration or judicial facilities or institutions to resolve double taxation conflicts where they cannot be resolved by mutual agreement procedures.”

As recently as 1993 Vicchi (1993, 175) concluded: “It would be worthy to think about the possibility of creating international courts specialized in double taxation ...”

Similarly, Weizman commented (1993, 269): “It is, therefore, evident that the mutual agreement procedure must be supplemented by an international tax court or arbitration institution, which will guarantee that the tax treaties live up to their purpose of “preventing double taxation”. An international tax court would be preferable since it would insure the uniform interpretation of tax treaties ...”

2.04 Nowadays, tax treaties are again contemplating international adjudication

The 1985 draft Germany/Sweden tax treaty marked the start of a new trend towards States accepting that tax treaty disputes should be resolved by international adjudication. Articles 44(1) and (2) of this 1985 draft were comparable to Article 25(4) of the 1977 OECD Model – but the rest of its Article 44 was a post-war novelty.

Guttentag and Misback (1986, 355) described this novel solution as “a welcome

experiment". Those interested in seeing the results of this experiment experienced some frustration because, although this draft was signed in 1985, ratification never took place – for reasons unconnected with its Article 44(5). An arbitration clause is, however, present in the 1992 Germany/Sweden tax treaty – see below.

The August 1989 Germany/US tax treaty was an ever more significant initiative in this area – both because of its content and because of the influence of these two States. Lindencrona and Mattsson (1990, 273) have described it as “the real breakthrough of arbitration in international tax disputes”.

Article 25(5) of this treaty runs (*italics added*): “5. Disagreements between the Contracting States regarding the interpretation or application of this Convention shall, as far as possible, be settled by the competent authorities. If a disagreement cannot be resolved by the competent authorities it may, *if both competent authorities agree*, be submitted for arbitration. The procedures shall be agreed upon and shall be established between the Contracting States by notes to be exchanged through diplomatic channels.”

Paragraph 24 of the Contemporaneous Protocol to this treaty provides: “The decision of the arbitration board in a particular case shall be binding on both Contracting States with respect to that case.”

Article 25 therefore permits tax treaty disagreements between the two States to be settled by binding arbitration – but, again, only if *both* States agree.

The September 1989 Protocol to the 1959 France/Germany tax treaty also contains an arbitration clause. Article 7 of the Protocol, adding an Article 25A to the treaty, provides that if the competent authorities cannot reach an agreement within 24 months from the date a taxpayer has presented his case, they may decide to appoint an Arbitration Commission. This Commission “shall resolve the disagreement in accordance with the rules of international law and, especially, with the provisions of this Convention.”

Article 41 of the 1992 Germany/Sweden tax treaty is comparable to Article 44 of the 1985 draft Germany/Sweden tax treaty referred to above.

Article 41(3) of this 1992 treaty provides: “The competent authorities may together authorise an independent body to give an expert opinion on a question submitted to such body.”

Article 41(4) runs: “Where the procedure is related to a particular case, the persons concerned shall be permitted to be heard; they shall have the right to submit their own requests.”

Article 41 thus gives taxpayers the right to have a hearing and propose a motion – but no more. Taxpayers do not have the right to invoke the far-reaching Article 41(5).

Article 41(5) begins: “The provisions of Chapters I, II and IV of the April 29 1957 European Convention for the Peaceful Settlement of Disputes shall be applied to settle international conflicts arising under this Convention.” This European Convention provides for States (only) to refer treaty interpretation disputes to the International Court of Justice, and other disputes to conciliation or arbitration.

Article 41(5) then provides for an alternative procedure – which is, once again, only

available if *both* States agree. It continues: “Instead of the procedure stipulated therein, the Contracting States may, however, agree to submit a dispute to a court of arbitration, whose decision shall be binding. Such court of arbitration shall be composed of professional judges of the Contracting States, third States or international organizations. Its procedure shall follow internationally recognized principles. The persons concerned in the case shall have the full right to be heard and to submit their own requests. The decision of the court shall be made on the basis of the provisions of agreements in force between both Contracting States and of the general international law; a decision *ex aequo et bono* shall not be allowed ... ”

Arbitration is also contemplated in the 1993 Mexico/US and Netherlands/US tax treaties – but, once again (to the disappointment of, at least, Mexico), only if *both* States agree.

The Mexico/US arbitration procedures are not to go into effect until, after a period of three years following the entry into force of the tax treaty, the competent authorities determine that it would be appropriate to exchange notes making effective the arbitration procedures. A similar waiting period applies to the Netherlands/US arbitration procedures, it being understood that notes will be exchanged when both competent authorities are satisfied with the voluntary arbitration provision in the 1989 Germany/US tax treaty (see above) or the (ostensibly mandatory) arbitration provision in the EU draft Arbitration Convention (see Chapter 2.05).

2.05 *The supranational adjudication of EU tax treaty disputes*

In the future, tax treaty provisions are increasingly likely to be discussed at an EU (European Union) supranational level by the European Court of Justice. (I normally use the word “international” to denote a purely public international context – i.e. one where only States (and not taxpayers) may litigate. I normally use the word “supranational” to denote a non-domestic context where States and taxpayers may litigate and where national courts may apply for a supranational decision under, for example, Article 177 of the EU Treaty of Rome.)

The European Court of Justice has already been confronted with the effect of tax treaty Articles in a discrimination context – see Chapter 12.13. It may be asked to rule on whether the limitation on benefits Articles in the 1989 Germany/US and 1993 Netherlands/US tax treaties are compatible with the Treaty of Rome’s non-discrimination provisions. It is also likely to be faced with other cases. Some may also involve conflicts between tax treaty provisions and other fundamental EU principles and freedoms, such as the free movement of workers (Article 48), freedom of establishment (Article 52), freedom to provide services (Article 59) and the free movement of capital (Articles 67 and 69). Others may involve conflicts between tax treaty provisions and EU legislation, possibly involving dividends and interest, their related EC Directives and “treaty-shopping”.

It has also long been likely that the EU will eventually endorse the international or supranational adjudication of tax treaty transfer pricing disputes. Such adjudication

may involve the application of principles of public international law (and, possibly, supranational EU law) as well as domestic laws – so that a tax treaty’s dual status as a treaty, and as domestic legislation, will be highlighted. Such adjudication is also likely to highlight that, as Easson has commented (1993, 1): “... the Community undoubtedly has a legal system that is distinct both from the legal systems of its Member States and from the system of international law.”

Sooner or later, EU adjudicators are likely to be faced with the fact that a tax treaty involves not only the rights and obligations of States *as between themselves* (a matter of public international and, possibly, EU law) but also the (perhaps different) rights and obligations of States vis-à-vis taxpayers and vice-versa (a matter of domestic and, possibly, EU law).

A November 29 1976 EU Commission draft Directive for compulsory arbitration in transfer pricing disputes first mooted the possibility of international adjudication. However, this draft Directive was not adopted by the EU Council; it was not until July 23 1990 that it re-emerged as a draft Arbitration Convention.

Member States preferred a Convention to a Directive because, once again, they preferred to retain the power to resolve tax treaty disputes. An EU Directive inevitably endows taxpayers with rights – which can then be adjudicated upon by the European Court of Justice. An EU Directive thus compromises Member States’ sovereignty. However, a Convention (or treaty) *between States* (only) need give no rights to individual taxpayers – see Chapter 16.01. Because taxpayers cannot require States to implement the provisions of the draft Arbitration Convention, its apparently mandatory nature is more ostensible than real.

Nevertheless, this EU draft Arbitration Convention does give taxpayers involved in pricing disputes with different EU taxing authorities the right to request (only) that such disputes be referred to (non-binding) arbitration – when taxpayers may appear or be represented. A small step for taxpayers – though perhaps a giant step for national tax authorities.

The EU 1990 draft Arbitration Convention applies when double taxation arises because EU Member States (or any other signatories) cannot agree on transfer pricing between EU enterprises. When an EU enterprise considers that this has resulted in double taxation, it may inform its competent authority (Article 6). If the competent authorities fail to reach an agreement that avoids double taxation within two years thereafter, Article 7(1) requires them to set up an advisory commission. However, if the case has been submitted to a domestic court, this two year period only begins to run once the judgment of the final court of appeal has been given – typically, years later. Furthermore, “[w]here the domestic law of a Contracting State does not permit the competent authorities of that State to derogate from the decision of their judicial bodies”, Article 7(3) provides that Article 7(1) shall not apply unless, effectively, domestic court proceedings have been abandoned – see Chapter 27.09.

Article 11 requires the advisory commission to deliver its opinion within the (short) period of six months from the date a matter is referred to it. Article 12 obliges

Contracting States to “take a decision which will eliminate the double taxation within six months of the date on which the advisory commission delivered its opinion.”

The competent authorities may take a decision which deviates from the advisory commission’s opinion. If they fail to reach an agreement, they are obliged to act in accordance with that opinion.

Article 9(2) requires the advisory commission to keep all evidence (and its opinion) secret. Furthermore, under Article 12(2), the final decision by the Contracting States may only be made public if they and the taxpayers concerned all agree. Regrettably, these provisions will hinder the development of precedents in this area.

The chances of this Convention ever coming into force are debatable – for two reasons. Firstly, no EU State can be required to sign and implement a Convention (as opposed to a Directive). Secondly, entry in force of this Convention is conditional upon *all* signatory States depositing their instruments of ratification by April 30 1995. This date is arrived at as follows. The date of conclusion of the Convention was July 23 1990. Under Article 20 it was concluded “for a period of five years” (only). However, under Article 18, it shall only enter into force on the first day of the third month following that in which the *last* signatory State deposits its instrument of ratification.

Despite this Convention’s shortcomings, it evidences the increasing likelihood of some tax treaty disputes being settled at an international/supranational level.

2.06 Conclusion: international/supranational tax treaty litigation is increasingly likely

Tillinghast has commented (1993, 351): “... there seems to be a growing consensus that arbitration should be made available as the ultimate dispute resolution mechanism in appropriate cases.” In line with this, States are now again agreeing to compromise their sovereignty by accepting the international/supranational adjudication of tax treaty disputes – some fifty years after they first did so. This development is likely to lead to greater attention being paid to principles of public international law.

For example, the US tax treaties with Germany (1989), Mexico (1993) and the Netherlands (1993), all provide (*italics added*): “The arbitration board shall decide each specific case on the basis of the Convention, giving due consideration to the domestic laws of the Contracting States and *the principles of international law.*”

Domestic courts worldwide should now focus on these principles – and evolve a uniform approach to tax treaty interpretation. As indicated in Chapter 1, this approach must recognise a tax treaty’s dual status – yet be independent of interpretative principles applicable only in a purely public international, or in a purely domestic, context; it must, perforce, be autonomous.

Chapter 3 Domestic approaches to (tax) treaty interpretation

3.01 *The application of public international law at a domestic level*

At a public international level, the interpretation of treaties (including tax treaties) between States is governed by public international law. Public international law in this area has been codified in the Vienna Convention on the Law of Treaties. This Treaty came into force on January 27 1980 (when the thirty fifth State signed it).

The most authoritative Commentary on the meaning of the Vienna Convention's text is that by the International Law Commission (ILC) on the Convention's final drafts. Accordingly, numerous extracts from this ILC Commentary appear in the following Chapters; references to Article numbers have been changed to reflect their final numbering in the Convention.

Some of the States which have ratified or acceded to the Vienna Convention include: Austria, Australia, Canada, Denmark, Germany, Italy, Japan, the Netherlands, New Zealand, Spain, Sweden, and the UK. The US has signed the Vienna Convention but has not ratified it – perhaps because it plans to take a “second look” (see Chapter 25.04).

At a public international level, the Vienna Convention is binding *as between these States* – at least as regards subsequent treaties between them. Strictly speaking, the Vienna Convention does not apply to treaties concluded before it came into force on January 27 1980, or to treaties where one or more of the parties has not ratified the Convention. However, to the extent that this Convention accurately codifies customary international law, it applies to all treaties – because all treaties are governed by customary international law. In line with Lord Diplock's comments in *Fothergill* (see Chapter 3.13), many domestic courts are ready to accept that this Convention does codify existing public international law – so that it does apply to any (tax) treaties concluded prior to (or after) 1980, irrespective of whether any of the contracting States have ratified it.

At a domestic level, domestic courts are also typically obliged to apply customary international law. In the UK, for example, customary international law is, as Professor Higgins commented (1987, 125), “part of the law of the land”. Customary international law is part of English law without any specific legislative act being needed for it to achieve that status. Thus, when an international treaty (such as the Vienna Convention) is accepted as codifying customary international law, it is automatically part of English law – because it is customary international law.

Accordingly, the Vienna Convention's interpretative Articles do not need any specific legislative act for English domestic courts to accept them as part of English law – providing these courts accept (as they have done, perhaps too readily) that these Articles reflect customary international law. This may explain why the Vienna Convention has not been specifically enacted into UK law: to the extent that it codifies customary public international law, it does not need to be. Only those treaties which do not reflect customary international law – such as tax treaties – have to be enacted into

English law for them to be cognisable by UK domestic courts.

This position can lead to confusion. For example, in seeking to show why a UK court should ignore a self-serving competent authority agreement (see Chapter 27.17), White commented (1991, 35): “The Vienna Convention is not incorporated into UK municipal law by any enactment.”

Such incorporation is not, of course, needed – because, to the extent that the Vienna Convention reflects customary public international law, it already is law in the UK.

In his reply to White, Avery Jones commented (White 1991, 37): “... there can be no doubt that a double taxation agreement is a treaty which should be interpreted in accordance with the general principles of international law for interpreting treaties, of which the articles in the Vienna Convention are a codification. There is no need for the Vienna Convention to be specifically incorporated into internal law to have effect.” As authority for his reply, Avery Jones cites (1991, 37 Footnote 3) Lord Diplock’s debatable proposition in *Fothergill* (at [1981] A.C. 283 – see Chapter 3.13) that UK courts may be under a constitutional obligation to interpret all treaties in accordance with the Vienna Convention.

This reply may give the impression that a tax treaty should always be interpreted strictly in accordance with all the Articles in the Vienna Convention. This is not the case; even though the Vienna Convention is law in the UK without any enactment being necessary, it should not be applied rigidly to tax treaty disputes between States and taxpayers – because it only governs disputes between States themselves. Whilst it may be appropriate to apply some principles of international law (and of the Vienna Convention) at a domestic level, it may be quite inappropriate to apply others without substantial modifications – see Chapters 1, 15-17, 21, 26 and 27.

The proposition that UK courts should interpret a treaty in accordance with the Vienna Convention is best expressed as only a (rebuttable) *prima facie* presumption that this should occur. As so expressed, this proposition is in harmony with the accepted relationship between public international law, treaties and UK domestic law. Lord Diplock himself commented (in *Salomon v. Commissioners of Customs and Excise*; [1967] 2 Q.B. 116 at 143): “... there is a *prima facie* presumption that Parliament does not intend to act in breach of international law, including therein specific treaty obligations; ...” By analogy, there can only be a (rebuttable) *prima facie* presumption that Parliament does not intend tax treaties to be interpreted in breach of the principles of international law codified in the Vienna Convention. In some circumstances it may only be appropriate for these principles to apply, if at all, in a domesticated form – see Chapter 1.05.

3.02 *The interpretation of (tax) treaties at a domestic level*

Several decades before the Vienna Convention on the Law of Treaties, the UK House of Lords recognised that, when it was interpreting legislation based word for word on multilateral commercial treaties, it should adopt a broader approach than when it was interpreting purely domestic legislation. Their Lordships held that they should modify

their traditional textual approach and construe such material on “broad principles of general acceptance” – which I describe as “the UK broad approach”.

The essence of this UK broad approach is that domestic courts should interpret multilateral commercial treaties on a basis that is consistent with generally accepted international practice. To achieve this, they can consider travaux préparatoires, jurisprudence (foreign decisions) and doctrine (the commentaries of learned authors).

Although this UK broad approach has evolved in relation to multilateral commercial treaties, it can also be applied to bilateral tax treaties – based on a standard Convention (such as the 1977 and subsequent OECD Models) and using “international tax language”. Domestic courts in Australia, New Zealand and the UK have specifically held to this effect, as detailed below.

This UK broad approach is so consistent with the basic approach in Article 31(1) of the Vienna Convention that, in practice, the two approaches are often indistinguishable. For example, in UK: *Commerzbank* (Article 7 and see Chapter 3.14), Mummery J. convincingly fused both approaches into one. New Zealand courts have similarly held that the UK broad approach is no different to that applicable under New Zealand domestic law – and they have also held that the basic approach in Article 31(1) of the Vienna Convention is no different to that applicable under New Zealand domestic law (see Chapter 3.07).

A uniform, autonomous approach to tax treaty interpretation, to be adopted by domestic courts worldwide, could therefore be modelled on Article 31(1) of the Vienna Convention and on the similar UK broad approach.

Indeed, domestic courts in Australia, Canada, Germany, New Zealand, Switzerland and the UK have already held that the approach to treaty interpretation in Article 31(1) of the Vienna Convention applies to tax treaties, as detailed below.

3.03 Australia: tax treaties and the Vienna Convention

December 20 1988 *Thiel* (Article 7) involved the 1980 Switzerland tax treaty and, even though Switzerland was not a party to the Vienna Convention, the Full Federal Court and the Full High Court cited this Convention frequently.

In the Full Federal Court, Sheppard J., after quoting from UK: *Fothergill* (see Chapter 3.13), commented (89 ATC 4,033): “In *Koowarta v. Bjelke-Petersen* (1981-1982) 153 C.L.R. 168 Brennan J. considered (p. 265) that provisions in domestic statutes corresponding with treaty provisions should be construed in accordance with the meaning attributed to the treaty in international law and therefore in accordance with the Vienna Convention. He considered Art. 31 of that Convention as “the leading general rule of interpretation of treaties”. In *The Commonwealth v. Tasmania* (the *Tasmanian Dam case*) (1983) 158 C.L.R. 1 Brennan J. said (page 222): “The interpretation of the Convention [...] should follow the articles of the Vienna Convention, the provisions of which codify existing customary law and furnish presumptive evidence of emergent rules of general international law. It is thus appropriate to refer to the Vienna Convention though it had not entered into force when

the Convention was adopted ...”

In the *Koowarta case*, Brennan J. was the only judge to refer to the Vienna Convention. In the *Tasmania Dam case* it was referred to by Gibbs C.J., Mason, Wilson and Dawson JJ. Gibbs C.J. was prepared to refer to the Vienna Convention because, in his view, it did no more than confirm existing practice. He referred with approval to *Monarch Airlines* [UK: *Fothergill* – see Chapter 3.13]; see p. 472. I refer also to *Mason J.* at p. 490, *Wilson J.* at p. 515 and *Dawson J.* at p. 566.

Whether or not the Vienna Convention does directly apply to the Swiss Agreement, the *Koowarta* and *Tasmanian Dam cases* establish that its provisions bear on the construction of the agreement.”

In the Full High Court, Dawson J. commented (90 ATC 4,722): “Switzerland is not a party to the Vienna Convention (although Australia is) but the relevant rules which it lays down are applicable, being no more than an indorsement or confirmation of existing practice: *The Commonwealth v. Tasmania* (the *Tasmanian Dam case*) (1983) 158 C.L.R. 1 at pp. 93-94, 222; *Fothergill v. Monarch Airlines Ltd.* (1981) A.C. 251 at pp. 276, 282.”

McHugh J. commented similarly (90 ATC 4,727): “The Agreement is a treaty and is to be interpreted in accordance with the rules of interpretation recognised by international lawyers: *Shipping Corporation of India Ltd. v. Gamlen Chemical Co. (Al Asia) Pty. Ltd.* (1980) 147 C.L.R. 142 at p. 159. Those rules have been codified by the Vienna Convention on the Law of Treaties to which Australia, but not Switzerland, is a party. Nevertheless, because the interpretation provisions of the Vienna Convention reflect the customary rules for the interpretation of treaties, it is proper to have regard to the terms of the Convention in interpreting the Agreement, even though Switzerland is not a party to that Convention: *Fothergill v. Monarch Airlines Ltd.* (1981) A.C. 251 at pp. 276, 282, 290; *Commonwealth v. Tasmania* (the *Tasmanian Dam case*) (1983) 158 C.L.R. 1 at p. 222; *Golder case* (1975) 57 I.L.R. 201 at pp. 213-214.”

These holdings are unsurprising – because Australia’s statutory rules (in the Acts Interpretation Act 1901) for interpreting domestic statutes differ little from the rules in Articles 31 and 32 of the Vienna Convention. As Bloom commented (1993, 183): “... the only difference of any substance is that under domestic principles recourse cannot be had to the negotiations which preceded the statute or to its various drafts. Moreover, there is a striking similarity between Article 32 of the Vienna Convention and section 15AB(1) of the Acts Interpretation Act as to the circumstances in which recourse can be had to extrinsic materials.” Even the difference referred to by Bloom may not exist to quite the same extent following the UK House of Lords decision of *Pepper v. Hart* (see Chapters 3.15 and 25.03).

3.04 Canada: tax treaties and the Vienna Convention

Canadian courts have often cited the Vienna Convention – even in relation to tax treaties which pre-date it. This is permissible because, in common with *Fothergill* (see Chapter 3.13), these courts accept that the Vienna Convention codifies existing public

international law.

September 7 1979 *Hunter Douglas* (Article 10) involved the 1957 Netherlands tax treaty. Grant D.J. commented (79 DTC 5345): “The Vienna Convention on the Law of Treaties, to which both Canada and the Netherlands are parties, contains the general rules of interpretation of international conventions.” He then cited Article 31(1) of the Vienna Convention.

Grant D.J. also referred to Article 31(1) of the Vienna Convention in Canada: September 28 1982 *Melford* (Article 7, 80 DTC 6077) in relation to the 1956 Germany tax treaty. Curiously, he was the only Judge to do so – despite the fact that *Melford* went up to the Supreme Court (which reached the right result for the wrong reason – see Chapter 10.08).

January 28 1985 *Gladden Estate* (Article 13) involved the 1942 US tax treaty. Addy J. commented (85 DTC 5191): “Contrary to an ordinary taxing statute a tax treaty or convention must be given a liberal interpretation with a view to implementing the true intentions of the parties. A literal or legalistic interpretation must be avoided when the basic object of the treaty might be defeated or frustrated insofar as the particular item under consideration is concerned.

Article 31 of the Vienna Convention on the *Law of Treaties* (1969) to which Canada subscribed governs the general rule of interpretation to be applied. Paragraph 1 of that Article reads as follows: 1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”

Addy J. then also referred to Article 32 of the Vienna Convention – see Chapter 24.01.

3.05 Germany: tax treaties and the Vienna Convention

Germany: August 21 1985 *BFH* (Article 15) invoked Article 33 of the Vienna Convention to hold that different wording in the German and Spanish texts of the 1966 Spain tax treaty should be interpreted to have the same meaning – see Chapter 20.04.

In Germany: October 9 1985 *BFH* (Article 7) the German Federal Ministry of Finance unsuccessfully invoked the Vienna Convention to support its claim that the practice of the tax authorities of the two States in relation to the 1954 US tax treaty was evidence as to the meaning of this treaty text – see Chapters 17.02 and 27.13.

Germany: January 27 1988 *BFH* (Article 10) held that the approach to treaty interpretation in Article 31(1) of the Vienna Convention applied to the 1954 US tax treaty. The treaty words were to be given their “ordinary meaning” – providing this did not lead to a result that was “manifestly absurd or unreasonable”.

3.06 Netherlands: tax treaties and the Vienna Convention

In Netherlands: July 3 1991 *HR* (Article 13), involving the 1970 Belgium tax treaty, Advocate-General Van Soest referred to the Vienna Convention – even though it only came in force in the Netherlands on May 9 1985.

3.07 New Zealand: tax treaties and the Vienna Convention

In New Zealand: July 16 1973 *UDT* (Article 24) counsel for both parties, McCarthy P. (at 1 NZTC 61,031), and White J. (at 1 NZTC 61,037) all approved of Lord Macmillan's broad approach in *Stag Line* (see Chapter 3.10) that treaty language "should be construed on broad principles of general acceptance". The Judges held that this UK broad approach is no different to that applicable under New Zealand law.

McCarthy P. commented (1 NZTC 61,031 and 61,032, final italics added): "Counsel were in concert that New Zealand Courts should take this broad approach and that this was really not in any material sense different from that enjoined on us, when interpreting domestic law, by the provisions of the *Acts Interpretation Act 1924*. So I shall proceed from that agreed starting point: We are not to adopt a narrow interpretation but to interpret having regard to the broad intentions of the framers *as they emerge from the text.*"

Similarly, New Zealand: June 14 1990 *JFP Energy* (Article 15) held that it was unnecessary to decide whether the Vienna Convention was applicable to tax treaties – because, as the parties and the Judges all agreed, its approach was not significantly different from that applicable under general law.

In the High Court, Eichelbaum C. J. (Chief Justice) commented (11 NZTC 6,285 and 6,286): "On behalf of the Objector it was submitted that the Court should apply the general rules for the interpretation of treaties contained in the Vienna Convention on Treaties of 1969, ratified by the NZ House of Representatives in 1971. In particular I was referred to art 31 and 32. I do not need to decide the issue (on which there were no submissions from the Commissioner) because putting aside art 32, referring to "supplementary means of interpretation", I do not think that in this case the general rule of interpretation set out in art 31 involves any significantly different approach from that applicable under general law. In *C of IR v United Dominions Trust Ltd* [July 16 1973 *UDT* – Article 24] (1973) 1 NZTC 61,028 at p 61,031; [1973] 2 NZLR 555 at p 558, McCarthy P noted that writers on international law seemed to agree it was difficult to state generally accepted principles relating to treaty interpretation with precision. In that case, the President said, there was common ground in favour of a tentative conclusion that English Courts do not interpret a treaty solely in the light of doctrines peculiar to English law, but – "... attempt to construe it as a whole taking into account its objects and purpose, in an endeavour to give effect to the expressed intentions of its framers" (at NZTC p 61,031; NZLR p 558)." (Eichelbaum C.J. made comparable comments in New Zealand: October 2 1992 *Squibb* – Article 26; at 13 NZTC 8,133.)

In the Court of Appeal, Richardson J. commented (12 NZTC 7,179): "In construing art 15 it is important to keep in mind that the double taxation relief agreement is part of a network of international agreements using international language, substantially similar in form and effect and designed, as the Commentary to art 1 (para 7) notes, to promote exchanges of goods and services and the movement of capital and persons in international trade by eliminating international double taxation. The OECD Convention

rules have an international currency used as they are by and in countries throughout the world and accordingly the language of the rules should be construed on broad principles of general acceptance and having appropriate regard to the Commentary and any travaux préparatoires (*C of IR v United Dominions Trust Ltd* [New Zealand: July 16 1973 *UDT* – Article 24] (1973) 1 NZTC 61,028; [1973] 2 NZLR 555, *Stag Line Ltd v Foscolo, Mango and Co Ltd* [UK: *Stag Line* – see Chapter 3.10] [1932] AC 328; and see also *Fothergill v Monarch Airlines* [UK: *Fothergill* – see Chapter 3.13] [1981] AC 251 and *Thiel v FC of T* [Australia: August 22 1990 *Thiel* – Article 7] 88 ATC 4094; 20 ATR 170). But it is not necessary to go any further into international interpretation questions because it was not suggested that in this case the standard New Zealand interpretation approach to such questions would differ in any essentials from an approach grounded in art 31 and 32 of the *Vienna Convention on Treaties*.”

3.08 Switzerland: tax treaties and the Vienna Convention

Switzerland: *November 9 1984 Bundesgericht* (Article 10) cited Article 31 of the Vienna Convention in support of its (criticised) holding, in relation to the 1951 Netherlands tax treaty, that: “ When changes in external circumstances take place an international treaty can, if appropriate, be interpreted and applied in a more rigorous manner than in the past, at least to the extent that one does not depart from the framework of the text ...”

3.09 UK: the broad approach to treaty interpretation

Years before the Vienna Convention came into force, UK courts evolved a “broad approach” to treaty interpretation which is difficult to distinguish from the approach in Article 31(1) of the Vienna Convention. An understanding of this UK broad approach clarifies the basic approach in Article 31(1) of the Vienna Convention – and highlights the extent to which the Vienna Convention can apply, unmodified, in a domestic context. To facilitate an understanding of this UK broad approach, the leading House of Lords decisions on it, and on the use of *travaux préparatoires*, are summarised below. Schreuer (1971) summarises earlier decisions in the UK and elsewhere.

3.10 UK: *Stag Line*

Stag Line (*Stag Line, Limited v. Foscolo, Mango and Company, Limited*; House of Lords; [1932] A.C. 328) involved the UK’s Carriage of Goods by Sea Act, 1924. This Act adopted the Hague Rules which resulted from the International Conference on Maritime Law held at Brussels in 1922 and 1923.

In *Stag Line* two engineers joined a ship to test some equipment. This test had to be delayed because, as Lord Buckmaster put it ([1932] A.C. 332): “The firemen on board the ship were not in possession of their full energies when the boat started ... owing to excessive drinking ...” This delay meant that, in order to discharge the engineers, the ship had to deviate from its normal course. Prior to rejoining its normal course, the ship hit a rock and sank. The respondents claimed for the loss of their cargo. Their

Lordships decided that the deviation was not “reasonable” under the 1924 Act.

Lord Atkin observed ([1932] A.C. 342 and 343) that this 1924 Act was “... not intended to codify the English law, but is the result (as expressed in the Act) of an international conference intended to unify certain rules relating to bills of lading. ... and the rules will often have to be interpreted in the courts of the foreign consignees. For the purpose of uniformity it is, therefore, important that the Courts should apply themselves to the consideration only of the words used without any predilection for the former [English] law, always preserving the right to say that words used in the English language which have already in the particular context received judicial interpretation may be presumed to be used in the sense already judicially imputed to them.”

In the penultimate paragraph of his judgment Lord Macmillan observed ([1932] A.C. 350, italics added): “It is important to remember that the Act of 1924 was the outcome of an International Conference and that the rules in the Schedule have an international currency. As these rules must come under the consideration of foreign Courts it is desirable in the interests of uniformity that their interpretation should not be rigidly controlled by domestic precedents of antecedent date, but rather that the language of the rules should be construed on *broad principles of general acceptance*.”

Stag Line has been approved in many non-tax treaty decisions, both in the UK and abroad. Approval has normally centred on the above observation by Lord Macmillan. This observation was cited with approval by Lords Hodson and Simonds in UK: *Riverstone* (see Chapter 3.11), was echoed by Lord Wilberforce in UK: *Buchanan* (see Chapter 3.12) and was approved by Lord Scarman in UK: *Fothergill* (see Chapter 3.13).

Lord Macmillan’s observation has also been approved in several tax treaty decisions, including Australia: June 12 1992 *Robinson* (Article 17 – and see Chapter 3.12 in relation to *Buchanan* and see Chapter 3.13 in relation to *Fothergill*), Canada: January 29 1968 *Furness Withy* (Article 8; 66 DTC 5363) and New Zealand: July 16 1973 *UDT* (Article 24; see Chapter 3.07) and June 14 1990 *JFP Energy* (Article 15; see Chapter 3.07).

3.11 UK: *Riverstone*

Riverstone (*Riverstone Meat Co. Pty. Ltd. v. Lancashire Shipping Co. Ltd.*; House of Lords; [1961] A.C. 807) involved Australia’s Sea Carriage of Goods Act, 1924. This Act also adopted the international Hague Rules at issue in *Stag Line* (Chapter 3.10). In *Riverstone*, all five Law Lords referred to numerous foreign decisions.

Lord Hodson approved ([1961] A.C. 874) Lord Macmillan’s observation in *Stag Line* and continued: “It is true that the possibilities of research are limited and that we have had no citation of authority from European maritime countries, but so far as this country, Canada, New Zealand and the USA are concerned ... the authorities are all consistent with one another and are adverse to the contention of the respondents.”

Lord Radcliffe observed ([1961] A.C. 868 and 869): “We are dealing, of course, with the Australian, not the United Kingdom, Act. The purport of the two Acts is, however,

the same, and each is designed to adopt the international Hague Rules. In the absence of any decisions of courts in Australia dealing with this particular point it is natural to found ourselves on English as well as American, Canadian and New Zealand decisions.”

Viscount Simonds approved ([1961] A.C. 837) of the speeches of Lords Atkin and Macmillan in *Stag Line*, and later mentioned ([1961] A.C. 843) two Canadian decisions “in the interest of uniformity”.

Lord Merriman reviewed ([1961] A.C. 850-856) US, Canadian and New Zealand decisions.

In the second paragraph of his speech Lord Keith of Avonholm commented ([1961] A.C. 869): “The weight of authority, not only in this country but in other countries of the Commonwealth and in the USA, whose sea trade and commerce form no negligible part of their economy, as also the history of the origins of the Hague Rules and the desirability of uniformity in their construction as between different nations, all go, in my view, to support the contentions of the appellants.”

3.12 UK: *Buchanan*

Buchanan (James Buchanan & Co. Ltd v. Babco Forwarding and Shipping (U.K.) Ltd; House of Lords; [1978] A.C. 141) involved the UK’s Carriage of Goods by Road Act 1965. s.1 of this Act gave the force of law in the UK to the international Convention on the Contract for the International Carriage of Goods by Road. This Convention was set out in the Schedule to the Act in English only – even though the French text was equally authentic (see Chapter 20).

In *Buchanan* a load of whisky being exported by trailer from Glasgow was stolen in England. The exporter then had to pay £30,000 excise duty. At issue was whether this excise duty was “a charge in respect of the carriage of goods”. If it was, it was payable by the carriers – in accordance with Article 23(4) of the Convention.

In the Court of Appeal ([1977] 1 Q.B. 208) Lord Denning M.R. commented ([1977] 1 Q.B. 213): “This article 23, paragraph 4, is an agreed clause in an international convention. As such it should be given the same interpretation in all the countries who were parties to the convention. It would be absurd that the courts of England should interpret it differently from the courts of France, or Holland, or Germany. ... We must, therefore, put on one side our traditional rules of interpretation. We have for years tended to stick too closely to the letter – to the literal interpretation of the words. We ought, in interpreting the convention, to adopt the European method.”

The majority of the members of the House of Lords disagreed with Lord Denning’s views on the applicability of what he supposed this European method to be, and upon whether a foreign corpus of law existed. Lord Salmon commented ([1978] A.C. 161) (in Ryan J.’s words in Australia: June 12 1992 *Robinson* – Article 17; 92 ATC 4,427): “If a corpus of law had grown up overseas which laid down the meaning of article 23, our courts would no doubt follow it for the sake of the uniformity which it is the object of the Convention to establish. But no such corpus exists.” His Lordship then adverted

to conflicting interpretations given by courts of different member countries, and continued (*ibid.*): “Our courts are therefore thrown back on their own resources. We must rely on our methods of interpretation and the broad principles I have attempted to state: see [*Stag Line* (Chapter 3.10) per Lord Macmillan].”

Similarly, no member of the House of Lords dissented from Lord Wilberforce’s view ([1978] A.C. 152E) that the Convention should be interpreted: “in a normal manner, appropriate for the interpretation of an international convention, unconstrained by technical rules of English law, or by English legal precedent, but on broad principles of general acceptance.”

Lord Wilberforce’s words, echoing those used by Lord Macmillan in *Stag Line* (see Chapter 3.10), were expressly approved by Lord Diplock in *Fothergill* (see Chapter 3.13). They were also approved by Mummery J. in UK: February 9 1990 *Commerzbank* (Article 7) when he outlined the approach that UK courts should adopt when interpreting tax treaties – see Chapter 3.14. They have also been approved in other jurisdictions in non-tax treaty cases. For example, they were approved by the Australian High Court in *Shipping Corporation of India Limited v. Gamlen Chemical Company Al Asia Limited* ((1980) 147 CLR 142) when it held (147 CLR 159): “It is important that we should adhere to this approach when we are interpreting rules which have been formulated for the purpose of regulating the rights and liabilities of parties to international ... transactions where great store is set upon certainty and uniformity of application.”

In *Buchanan* Viscount Dilhorne commented ([1978] A.C. 157): “In construing the terms of a convention it is proper and indeed right, in my opinion, to have regard to the fact that conventions are apt to be more loosely worded than Acts of Parliament. To construe a convention as strictly as an Act may indeed lead to a wrong interpretation being given to it. In construing a convention as in construing an Act where the language used is capable of two interpretations one must seek to give effect to the intentions of those who made it (Coke 4 Inst. 330).”

This comment was approved by Northrop J. in Australia: August 22 1990 *Thiel* (Article 7 and see Chapter 3.03; at 89 ATC 4,021).

3.13 UK: *Fothergill*

Fothergill (*Fothergill v. Monarch Airlines Ltd.*; House of Lords; [1981] A.C. 251) involved the UK’s Carriage by Air Act 1961. (This may surprise those tax treaty commentators – who shall remain nameless – who refer to this decision as “A good example of common interpretation in a tax treaty case ...”) This Act gave the force in law in the UK to the 1929 Warsaw Convention (as amended by the 1955 Hague Protocol). Schedule 1 of this Act set out both the English and the French texts of the Convention. Most unusually, s.1(2) of the Act provided that in the event of inconsistency the French text should prevail over the English text – see Chapter 20.

In 1975, some weeks after flying in from Italy, Mr. Fothergill noticed that some personal effects were missing from his suitcase. One issue was whether this (£16.50)

loss was “damage”. Damage had to be reported within seven days if the airline was to be held responsible under Article 26(2) of the Convention set out in Schedule 1 of the Act. Mr. Fothergill did not report his loss within this period.

The House of Lords concluded that “damage” should be given a wide meaning – and should include loss. In holding for Monarch Airlines, their Lordships considered (arguably *obiter*) whether recourse could be had to the *travaux préparatoires* relating to the Convention and its Protocol.

Lord Scarman commented ([1981] A.C. 293): “The broad approach of our courts to the interpretation of an international convention incorporated into our law is well settled. The international currency of the convention must be respected, as also its international purpose. The convention should be construed “on broad principles of general acceptance.” The approach was formulated by Lord Macmillan [... in *Stag Line* – Chapter 3.10 ...]; it was adopted by this House in the recent case of [... *Buchanan* – Chapter 3.12 ...].”

Lord Scarman’s comment was approved by Ryan J. in Australia: June 12 1992 *Robinson* (Article 17; 92 ATC 4,427).

Lord Diplock began his speech by distinguishing between a UK Parliamentary statute and “a multilateral international convention designed to achieve uniformity of national laws”. He commented ([1981] A.C. 281 and 282): “The language of an international convention has not been chosen by an English parliamentary draftsman. It is neither couched in the conventional English legislative idiom nor designed to be construed exclusively by English judges. It is addressed to a much wider and more varied judicial audience than is an Act of Parliament that deals with purely domestic law. It should be interpreted, as Lord *Wilberforce* put it in ... [*Buchanan* – see Chapter 3.12] ... , “unconstrained by technical rules of English law, or by English legal precedent, but on broad principles of general acceptance.” ”

These comments by Lord Diplock were also approved by Ryan J. in Australia: June 12 1992 *Robinson* (Article 17; 92 ATC 4,427).

Lord Diplock continued ([1981] A.C. 282): “My Lords, it would seem that courts charged with the duty of interpreting legislation in all the major countries of the world have recourse in greater or less degree to “travaux préparatoires,” or “legislative history” (as it is called in the US) in order to resolve ambiguities or obscurities in the enacting words; though the extent and character of the extraneous material to which reference is permitted under this head varies considerably as between one country and another.”

These comments by Lord Diplock were approved by Sheppard J. in Australia: August 22 1990 *Thiel* (Article 7; 89 ATC 4,032).

Lord Diplock continued ([1981] A.C. 282): “As Lord *Wilberforce* has already pointed out, international courts and tribunals do refer to *travaux préparatoires* as an aid to interpretation of treaties and this practice as respects national courts has now been confirmed by the Vienna Convention on the Law of Treaties (Cmnd. 4140), to which Her Majesty’s Government is a party and which entered into force a few months ago. It

applies only to treaties concluded after it came into force and thus does not apply to the Warsaw Convention and Protocol of 1955; but what it says in articles 31 and 32 about interpretation of treaties, in my view, does no more than codify already-existing public international law.”

In Australia: August 22 1990 *Thiel* (Article 7) Sheppard J. also noted (89 ATC 4,032) this comment by Lord Diplock that, although the Vienna Convention only applies to treaties concluded after it entered into force on January 27 1980, it does no more than codify already existing public international law.

Lord Diplock then suggested that because the UK had ratified the Vienna Convention, English courts “might well be under a constitutional obligation” to interpret Acts of Parliament giving effect to future treaties by applying this Convention. He commented ([1981] A.C. 283): “... in exercising its interpretative function of ascertaining what it was that the delegates to an international conference agreed upon by their majority vote in favour of the text of an international convention where the text itself is ambiguous or obscure, an English court should have regard to any material which those delegates themselves had thought would be available to clear up any possible ambiguities or obscurities. Indeed, in the case of Acts of Parliament giving effect to international conventions concluded after the coming into force of the Vienna Convention on the Law of Treaties (Cmnd. 4140), I think an English Court might well be under a constitutional obligation to do so. By ratifying that Convention, Her Majesty’s Government has undertaken an international obligation on behalf of the UK to interpret future treaties in this manner and since under our constitution the function of interpreting the written law is an exercise of judicial power and rests with the courts of justice, that obligation assumed by the UK falls to be performed by those courts.” These comments can lead to confusion – see Chapter 3.01.

In common with Kerr J. (in the High Court), and the Court of Appeal, Lord Diplock and his fellow Law Lords considered numerous foreign decisions, as well as textbooks and articles from Argentinian, Belgian, French and Swiss sources.

Lord Wilberforce considered the views of several foreign writers; he found their consensus “impressive” ([1981] A.C. 275) – and followed them. He commented ([1981] A.C. 276): “There is little firm authority in English law supporting the use of travaux préparatoires in the interpretation of treaties or conventions. The passage usually cited in support of such use is from the judgement of Lord Reading C.J. in *Porter v. Freudenberg* [1915] 1 K.B. 857, 876 when reference was made to statements made in a committee of the conference which prepared the Hague Convention of 1907 upon the Laws and Customs of War on Land. The judgment contains no reasoning in support of this approach, and the case was decided upon the wording of the relevant article in preference to the (inconsistent) statements. There is a passing reference to travaux préparatoires in relation to an international convention in *Post Office v. Estuary Radio Ltd* [1968] 2 Q.B. 740, *per* Diplock L.J., at p. 761, but even this is tentatively expressed. When dealing with an international treaty or convention I think that there is no doubt that international courts and tribunals ... do in general make use of travaux

préparatoires as an aid to interpretation ... This practice is cautiously endorsed by the Vienna Convention on the Law of Treaties (1969) (Cmnd. 4140), article 32.”

Lord Wilberforce concluded ([1981] A.C. 278 and see Chapter 21.04): “... I think that it would be proper for us ... to recognize that there may be cases where such travaux préparatoires can profitably be used. These cases should be rare, and only where two conditions are fulfilled, first, that the material involved is public and accessible, and secondly, that the travaux préparatoires clearly and indisputably point to a definite legislative intention. It would I think be unnecessarily restrictive to exclude from consideration, as travaux préparatoires, the work of the Paris Conference of 1925, and the work of the C.I.T.E.J.A. before 1929, both of which are well known to those concerned with air law, in any case where a clear intention were to be revealed.”

It may be no coincidence that Lord Wilberforce had been a member of the UK delegation on the Hague Protocol to this Convention – and that this delegation had proposed (as their Lordships held) that “damage” should include partial loss.

Lord Scarman followed Lord Wilberforce’s approach. He commented ([1981] A.C. 294 and see Chapter 25.02): “I come now to consider to what aids our courts may have recourse in interpreting an international convention. It matters not how the convention has entered into our law. Once it is part of our law, its international character must be respected. The point made by Lord Macmillan in *Stag Line Ltd. v. Foscolo, Mango & Co. Ltd.* [1932] A.C. 328, 350 [*Stag Line* – see Chapter 3.10] is to be borne in mind. Rules contained in an international convention are the outcome of an international conference; if, as in the present case, they operate within the field of private law, they will come under the consideration of foreign courts; and uniformity is the purpose to be served by most international conventions, and we know that unification of the rules relating to international air carriage is the object of the Warsaw Convention. It follows that our judges should be able to have recourse to the same aids to interpretation as their brother judges in the other contracting States. The mischief of any other view is illustrated in the instant case. To deny them this assistance would be a damaging blow to the unification of the rules which was the object of signing and then enacting the Convention. Moreover, the ability of our judges to fulfil the purpose of the enactment would be restricted, and the persuasive authority of their judgements in the jurisdictions of the other contracting states would be diminished.

We know that in the great majority of the contracting states the legislative history, the “travaux préparatoires,” the international case law (“la jurisprudence”) and the writings of jurists (“la doctrine”) would be admissible as aids to the interpretation of the Convention. We know also that such sources would be used in the practice of public international law. They should, therefore, also be admissible in our courts: but they are to be used as *aids* only.

Aids are not a substitute for the terms of a convention: nor is their use mandatory. The court has a discretion.”

Lord Fraser of Tulleybelton endorsed ([1981] A.C. 287) Lord Wilberforce’s view on the relevance of “the writings of the learned authors from abroad” which “strongly

support the purposive construction of Article 26(2) ...”.

As regards *Fothergill*, in his superb book *The Vienna Convention on the Law of Treaties* Sinclair commented (1984, 146 and 147): “This judgment of the House of Lords has a significance over and above the particular interpretation given to the disputed clause in the convention. The dicta of Lords Wilberforce, Scarman and Diplock evidence a growing willingness on the part of the English courts to align their practice on the admissibility of *travaux préparatoires* of treaties incorporated into English law with the practice of the courts of other countries in Western Europe and North America. Given that most conventions which are likely to be litigated in municipal courts are, as Lord Diplock puts it, conventions “designed to achieve uniformity of national laws in some particular field of public or private law”, the development of judicial attitudes in *Fothergill v. Monarch Airlines* is to be commended, if only because it should tend to foster uniformity of interpretation.”

3.14 UK tax treaty interpretation; February 9 1990 *Commerzbank* (Article 7)

In *Commerzbank* Mummery J. discussed the approach that UK courts should adopt when interpreting tax treaties. The parties had agreed that the correct approach was that laid down by the House of Lords in *Fothergill* (see Chapter 3.13), and Mummery J.’s references below are to the court report of *Fothergill* at [1981] A.C. 251.

Mummery J.’s commendable approach, which takes account of the principles of public international law now codified in Article 31(1) of the Vienna Convention, is as follows ([1990] STC 297 and 298): “(1) It is necessary to look first for a clear meaning of the words used in the relevant article of the convention, bearing in mind that “consideration of the purpose of an enactment is always a legitimate part of the process of interpretation”: per Lord Wilberforce (at 272) and Lord Scarman (at 294). A strictly literal approach to interpretation is not appropriate in construing legislation which gives effect to or incorporates an international treaty: per Lord Fraser (at 285) and Lord Scarman (at 290). A literal interpretation may be obviously inconsistent with the purposes of the particular article or of the treaty as a whole. If the provisions of a particular article are ambiguous, it may be possible to resolve that ambiguity by giving a purposive construction to the convention, looking at it as a whole by reference to its language as set out in the relevant UK legislative instrument: per Lord Diplock (at 279).

(2) The process of interpretation should take account of the fact that – “The language of an international convention has not been chosen by an English parliamentary draftsman. It is neither couched in the conventional English legislative idiom nor designed to be construed exclusively by English judges. It is addressed to a much wider and more varied judicial audience than is an Act of Parliament which deals with purely domestic law. It should be interpreted, as Lord Wilberforce put it in *James Buchanan & Co. Ltd v. Babco Forwarding & Shipping (UK) Limited*, [see Chapter 3.12] [1978] AC 141 at 152, “unconstrained by technical rules of English law, or by English legal precedent, but on broad principles of general acceptance” ”: per Lord Diplock (at 281 to 282) and Lord Scarman (at 293).

(3) Among those principles is the general principle of international law, now embodied in art 31(1) of the Vienna Convention on the Law of Treaties, that “a treaty should be interpreted in good faith and in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose”. A similar principle is expressed in slightly different terms in McNair’s *The Law of Treaties* (1961) p 365, where it is stated that the task of applying or construing or interpreting a treaty is “the duty of giving effect to the expressed intention of the parties, that is, their intention as expressed in the words used by them in the light of the surrounding circumstances”. It is also stated in that work (p 366) that references to the primary necessity of giving effect to “the plain terms” of a treaty or construing words according to their “general and ordinary meaning” or their “natural signification” are to be a starting point or prima facie guide and “cannot be allowed to obstruct the essential quest in the application of treaties, namely the search for the real intention of the contracting parties in using the language employed by them”.

(4) If the adoption of this approach to the article leaves the meaning of the relevant provision unclear or ambiguous or leads to a result which is manifestly absurd or unreasonable recourse may be had to “supplementary means of interpretation” including *travaux préparatoires*: per Lord Diplock (at 282) referring to art 32 of the Vienna Convention, which came into force after the conclusion of this double taxation convention, but codified an already existing principle of public international law. See also Lord Fraser (at 287) and Lord Scarman (at 294).

(5) Subsequent commentaries on a convention or treaty have persuasive value only, depending on the cogency of their reasoning. Similarly, decisions of foreign Courts on the interpretation of a convention or treaty text depend for their authority on the reputation and status of the Court in question: per Lord Diplock (at 283-284) and per Lord Scarman (at 295).

(6) Aids to the interpretation of a treaty such as *travaux préparatoires*, international case law and the writings of jurists are not a substitute for study of the terms of the convention. Their use is discretionary, not mandatory, depending, for example, on the relevance of such material and the weight to be attached to it: per Lord Scarman (at 294).”

Baker, whilst accepting that Mummery J.’s approach is “proper”, has commented in his stimulating books (1991, 20 and 1994, 27): “When coming to his judgment, however, he threw aside this proper approach when he concluded that the “natural and ordinary” meaning of the words of the treaty article he had to construe were “clear”; that the construction contended for by the taxpayers “does not give rise to manifestly absurd or unreasonable consequences,” and he could “find no sufficient indication in the purpose of the convention or in its surrounding circumstances or in provisions in articles other than [the article he had to construe] to qualify the clear words.” These dicta are entirely redolent of the English courts’ literal approach to the interpretation of domestic legislation. It should not be forgotten that the *Commerzbank* case was the case where Mummery J. decided that an interpretation reached through mutual agreement

procedure was not binding, and that a person resident in a third state could take advantage of a treaty to which his state of residence was not a party.”

I disagree with most of Baker’s criticisms – for the following reasons. Firstly, Mummery J., far from throwing aside his “proper” approach, applied it meticulously. Secondly, Mummery J.’s dicta faithfully echo the very words of Articles 31 and 32 of the Vienna Convention – see Chapter 4. Thirdly, Mummery J.’s holding that an interpretation reached though mutual agreement is not binding in the UK is correct – see Chapters 16.03 and 27.17. Fourthly, Mummery J.’s holding that a resident of third State could take advantage of the 1945 UK/US tax treaty is also correct – see Chapter 26.01 (notably in relation to Netherlands: *September 2 1992 HR* – Article 10).

However, it is possible to criticise Mummery J.’s judgment on the grounds that, as Chapters 6.05 and 11.03 indicate, he should have found “sufficient indication in the purpose of the conventions ... to qualify the clear words.”

3.15 UK: travaux préparatoires and *Pepper v. Hart*

The UK judgments cited above stressed that the traditional UK approach to statutory interpretation, which precluded the use of travaux préparatoires (and Parliamentary (legislative) history), was not appropriate as regards international (commercial) treaties. Such treaties could only be interpreted uniformly by the adoption of a broad approach – which could take account of travaux préparatoires.

This distinction between these two UK approaches has been largely eliminated as a result of the 1992 House of Lords decision of *Pepper (Inspector of Taxes) v. Hart* ([1992] STC 898). By coincidence a tax case (but not a tax treaty case) *Pepper v. Hart* holds that, in appropriate circumstances, recourse can now be had to a UK statute’s Parliamentary history – see Chapter 25.03. This holding is based on an approach which is similar to that in Article 32 of the Vienna Convention.

3.16 US: tax treaties and the Vienna Convention

In the US, doubts have been expressed as to whether the Vienna Convention approach does in fact codify customary international law – and, hence, whether it should govern the interpretation of tax treaties by US courts. Thus, Section 325a. of the American Law Institute (ALI) *Restatement of the Law Third* begins: “a. Customary international law of interpretation. Customary international law has not developed rules and modes of interpretation having the definiteness and precision to which this section [which follows Article 31(1) of the Vienna Convention] aspires. Therefore, unless the Vienna Convention comes into force for the US, this section does not strictly govern interpretation by the US or by courts in the US. But it represents generally accepted principles and the US has also appeared willing to accept them despite differences of nuance and emphasis.”

These differences are discussed in Section 325g. of this *Restatement* which runs: “This section [which follows Article 31(1) of the Vienna Convention] suggests a mode of interpretation of international agreements somewhat different from that ordinarily

applied by courts in the US. Courts in the US are generally more willing than those of other states to look outside the instrument to determine its meaning. In most cases, the US approach would lead to the same result, but an international tribunal using the approach called for by this section may find the US interpretation erroneous and US action pursuant to that interpretation a violation of that agreement.”

This extra-textual tendency may explain why the Vienna Convention approach has not been applied by any US domestic courts in relation to tax treaties – and, in the absence of ratification, why it may never be so applied.

The American Law Institute has made proposals on US income tax treaties in an invaluable Report entitled *Federal Income Tax Project – International Aspects of US Income Taxation II* (the 1992 ALI Report). The 1992 ALI Report commented (27): “... in at least one respect it would be desirable if US interpretation practice conformed more closely to that of the Vienna Convention. On balance, US practice places undue weight on unilateral interpretative materials as opposed to materials that are the product of or otherwise reflect the mutual views of both parties to a bilateral convention.” This area is discussed in Chapters 6 and 25.

Part II *The Vienna Convention: Articles 31 and 33 – general rules of interpretation*

Chapter 4 A summary of Articles 31 - 33 of the Vienna Convention

4.01 *Treaty interpretation in public international law*

Public international law has traditionally recognised three main approaches to treaty interpretation.

The “textual” (or “ordinary meaning of the words”) approach analyses the *actual words in the text* of the treaty to ascertain the meaning of the treaty.

The “intentions of the parties” (or “founding fathers”) approach ascertains the *parties’ intentions*. The treaty is then construed to give effect to such intentions.

The “aims and objects” (or “teleological”) approach ascertains the *treaty’s aims and objects*. The treaty is then construed to give effect to these aims and objects.

For years controversy has raged over two issues: which approach is the most appropriate – and what material (apart from the treaty text itself) a court may consider. Both issues are highly relevant to the interpretation of tax treaties – and both of them are settled by Articles 31-33 of the Vienna Convention.

Article 31(1) of the Vienna Convention settles the first issue (i.e. which approach is most appropriate) by adopting the “textual” or “ordinary meaning of the words” approach as the starting point for the general rule of interpretation (see Chapter 6).

Article 32 of the Vienna Convention settles the second issue (i.e. what material a court may consider) by permitting the use of “supplementary means of interpretation”. This permits the use of a far wider range of materials and authorities than may often be permissible under domestic interpretative principles. In *practice*, it is difficult to avoid the conclusion that the use of *any* material which may be relevant to the interpretation of a treaty text is likely to be permissible under the Vienna Convention – see Chapters 4.03 and 21.01.

Article 31(1), giving primacy to a textual approach, and Article 32, permitting the use of a wide range of interpretative materials, may seem inconsistent – but they are not. This is because, as Lauterpacht commented (1935, 571) nearly sixty years ago: “The first and principal lesson which can be deduced from their [international tribunals’] practice is that in no circumstances ought preparatory work to be excluded on the ground that the treaty is clear in itself. Nothing is absolutely clear in itself.”

O’Connell observed similarly (1980, 253, footnotes omitted): “It is said that where a treaty clause is clear and unambiguous it does not require to be interpreted. However, it may be doubted if a clear and unambiguous clause has ever been devised.”

Typically, the very fact that the meaning of a treaty term is being litigated will itself be evidence that, to at least one of the litigants, this term is ambiguous or obscure.

As Lauterpacht noted (1935, 572): “As a rule both parties, while putting forward diametrically opposed contentions, claim that the disputed provision is clear.”

Thus, although the meaning of a treaty text may be *apparently* clear by applying Article 31(1) and the rest of Article 31, one can only be certain that such apparent

clarity accords with *real* or “informed” clarity once one has interpreted the treaty text by applying Article 32 – and considering all material relevant to its meaning.

As Lauterpacht (1935, 572) commented: “The controversial expression becomes scientifically clear only after we have caused to pass through it the “galvanic current” – to use Mr. Justice Holmes’ phrase [*Edited Footnote 90*: Holmes 1899, 417] – not only of the whole document but of all the evidence available. An overwhelmingly “clear” decision may be plunged into the depths of uncertainty by a ray of evidence; a doubtful and controversial term may by the same process achieve a decisive accession of strength and clarity. No clarity is so absolute as not to admit of a proof to the contrary.”

Lauterpacht concluded (1935, 593, in phrases he repeated later (1949, 51)): “It follows from what has been said that the statement that an expression is clear is – or ought to be – the result of the process of interpretation, not the starting point.”

Article 31(1) of the Vienna Convention runs: “*General rule of interpretation*

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”

In commenting on Article 31(1), Para. 12 of the ILC Commentary starts: “(12) *Paragraph 1* contains three separate principles. The first – interpretation in good faith – flows directly from the rule *pacta sunt servanda*. The second principle is the very essence of the textual approach: the parties are to be presumed to have that intention which appears from the ordinary meaning of the terms used by them. The third principle is one both of common sense and good faith; the ordinary meaning of a term is not to be determined in the abstract but in the context of the treaty and in the light of its object and purpose. These principles have repeatedly been affirmed by the Court. The present Court in its Advisory Opinion on the *Competence of the General Assembly for the Admission of a State to the United Nations* said: [*Footnote 130*: *I.C.J. Reports 1950*, p. 8; italics are added to the quote below.]

“The Court considers it necessary to say that the first duty of a tribunal which is called upon to interpret and apply the provisions of a treaty, is to endeavour to give effect to them in their natural and ordinary meaning in the context in which they occur. *If the relevant words in their natural and ordinary meaning make sense in their context, that is an end of the matter.*” ”

The fact that Article 31 clearly endorses the textual approach as the starting point of interpretation has implications for other approaches to treaty interpretation – notably those based on the “intentions of the parties” and the treaty’s “aims and objects”.

The adoption of the textual approach means that the “intentions of the parties” must be ascertained primarily from the actual treaty text – and not from non-treaty sources. This is clear from Para. 12 of the ILC Commentary quoted above – and is discussed further in Chapter 6.

Article 31(1)’s reference to a treaty’s “object and purpose” is more controversial.

O’Connell has taken the view (1974, 255) that Article 31(1) “... embodies the literal



and teleological techniques of interpretation, and by failing clearly to separate them would appear to concede that whenever a problem of interpretation arises the object of the treaty must be taken account. No precedence is allotted to literal interpretation.”

Sinclair has taken an opposite view. He commented (1984, 130): “... reference to the object and purpose of the treaty is, as it were, a secondary and ancillary process in the application of the general rule on interpretation. The initial search is for the “ordinary meaning” to be given to the terms of the treaty in their “context”; it is *in the light of* the object and purpose of the treaty that the initial or preliminary conclusion must be tested and either confirmed or modified.”

Sinclair’s view is preferable – because it is more consistent with the view, endorsed by Para. 9 of the ILC Commentary (see Chapter 4.02), that Article 31 must be read as a whole.

4.02 *Interpreting Article 31 as a whole*

The application of Article 31(1), the starting point for the general (textual) rule of interpretation, will normally reveal the ordinary meaning of the treaty text. To be certain that this ordinary meaning accords with the real meaning, the rest of Article 31 must also be applied. Article 31 must be read *as a whole*.

Sinclair commented (1984, 116): “Every text, however clear on its face, requires to be scrutinised in its context and in the light of the object and purpose it is designed to serve. The *conclusion* which may be reached after such a scrutiny is, in most instances, that the clear meaning which originally presented itself is the correct one, but this should not be used to disguise the fact that what is involved is a process of interpretation.”

However, although Article 31 must be applied as a whole, the ILC unanimously accepted that the meaning of the text of the treaty is – and must always remain – the starting point of interpretation.

Para. 9 of the ILC Commentary runs in part (italics added): “Once it is established – and on this point the Commission was unanimous – that *the starting point of interpretation is the meaning of the text*, logic indicates that “the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose” should be the first elements to be mentioned. Similarly, logic suggests that the elements comprised in the “context” should be the next to be mentioned since they form part of or are intimately related to the text. Again, it is only logic which suggests that the elements in paragraph 3 – a subsequent agreement regarding the interpretation, subsequent practice establishing the understanding of the parties regarding the interpretation and relevant rules of international law applicable in the relations between the parties – should follow and not precede the elements in the previous paragraphs. The logical consideration which suggests this is that these elements are extrinsic to the text. But these three elements are all of an obligatory character and by their very nature could not be considered to be norms of interpretation in any way inferior to those which precede them.”

Para. 11 of the ILC Commentary confirms that (initial italics added): “... the text must be presumed to be the authentic expression of the intentions of the parties; and that, in consequence, *the starting point of interpretation is the elucidation of the meaning of the text*, not an investigation *ab initio* into the intentions of the parties.”

Article 31(2) of the Vienna Convention runs: “**2. The context for the purpose of the interpretation of the treaty shall comprise, in addition to the text, including its preamble and annexes:**

(a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;

(b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.”

Para. 13 of the ILC Commentary runs: “(13) *Paragraph 2* seeks to define what is comprised in the “context” for the purposes of the interpretation of the treaty. That the preamble forms part of a treaty for purposes of the interpretation is too well settled to require comment, as is also the case with documents which are specifically made annexes to the treaty.” This area is discussed in Chapter 14.

Article 31(3) of the Vienna Convention runs in part: “**There shall be taken into account, together with the context: (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;**

(b) any subsequent practice in the application of the treaty which established the agreement of the parties regarding its interpretation; ...”

At a public international level, *as between treaty partner States*, account must be taken of any of their agreements and practices.

However, when a tax treaty is being applied at a domestic level – between State(s) and taxpayer(s) – subsequent agreements or practices of treaty partner States may have to be disregarded. At a domestic level, for example, no account should be taken of secret agreements or practices which taxpayers are wholly unaware of.

At a domestic level, therefore, Article 31(3) has limited applicability; these limits are discussed in Chapters 16, 17, 21 and 27.

Article 31(3) of the Vienna Convention continues in part: “**There shall be taken into account, together with the context: ...**

(c) any relevant rules of international law applicable in the relations between the parties.”

Article 31(3)(c) is, arguably, both self-evident and unclear.

It is self-evident that, at a public international level, any relevant rules of international law must be taken into account in interpreting a treaty.

It is unclear which “relevant rules” Article 31(3)(c) is referring to. Para. 16 of the

ILC Commentary reveals that Article 31(3)(c) is an attempt to refer to the principle of “contemporaneity” – which governs whether treaty terms should be interpreted in the light of the law contemporaneous with the date of conclusion of the treaty, or whether account may be taken of subsequent developments in such law. This principle is discussed in Chapters 9 and 10 (notably in relation to Article 3(2) of the 1977 and 1992 OECD Models) and in Chapter 18.

Article 31(4) of the Vienna Convention runs: “A special meaning shall be given to a term if it is established that the parties so intended.”

A special meaning is the converse of the ordinary meaning which Article 31(1) of the Vienna Convention requires to be given to treaty terms. Tax treaties use their own international tax language, so Article 31(4) may seem particularly relevant in a tax treaty context – but it is not. International tax language in a tax treaty is not “special” at all – because it is the *ordinary* technical language applicable in a tax treaty context.

Accordingly, Article 31(4) should rarely be applied to tax treaties – see Chapter 19.

Article 32 of the Vienna Convention runs: “Supplementary means of interpretation

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31:

(a) leaves the meaning ambiguous or obscure; or

(b) leads to a result which is manifestly absurd or unreasonable.”

4.03 In practice, recourse may always be had to supplementary means of interpretation

By referring to supplementary *means* of interpretation, Article 32 seems subordinate to the preceding Article 31 – which establishes *the general rule* of interpretation. However, this subordination is more apparent than real. Sinclair commented (1974, 116 – echoing Para. 19 of the ILC Commentary): “The distinction between the general rule of interpretation and the supplementary means of interpretation is intended rather to ensure that the supplementary means do not constitute an alternative, autonomous method of interpretation divorced from the general rule.”

Rosenne has even doubted whether a fundamental distinction should be made between Article 31’s “primary” elements of interpretation and Article 32’s “secondary” elements of interpretation. He opined (1966, 222): “... the formal limitation on the permission to employ what the Commission has entitled “supplementary means of interpretation” in article [32] is artificial and has no basis either in practice or in law, and certainly cannot be supported by such international jurisprudence as there is on this question.”

Fitzmaurice observed (1951, 5): “There is probably no school of thought which rejects recourse to *travaux préparatoires* in all circumstances, though some question whether it ever has much utility except to confirm or reinforce an interpretation already

fairly clear on the fact of the text itself. The real issue lies between those who consider that such recourse should be *quasi-habitual* (even where the text is apparently clear), and those who consider it should only be resorted to in case of patent ambiguity or obscurity, and then only if other means of resolving the difficulty have failed.

The first school maintains, in effect, that no disputed text is ever completely clear, or it would not be in dispute; that, in any case, even an apparently clear text is seldom so clear that reference to the records will not serve to make it clearer still, or, by confirming the meaning to be deduced from the text itself, add weight and force to the interpretation arrived at; finally, that the very notion of clarity is a subjective one. The same points are made *mutatis mutandis* about the terms “plain meaning” and “ordinary meaning”. The underlying feeling is that just as the selection of the correct rule of interpretation involves a previous process of interpretation, so, equally, the conclusion that the meaning of a text is clear, and therefore that no recourse to the records is called for, involves itself a process of interpretation, the result of which might have been different if the records had in fact been consulted.

The opponents of this view maintain that reference to *travaux préparatoires*, unless *ex necessitate*, is to be deprecated ...”

In practice, it is difficult to avoid the conclusion that recourse may *always* be had to supplementary means of interpretation to confirm a meaning resulting from the application of Article 31. Even when the meaning of a treaty text is apparently clear, counsel (on both sides) will typically seek to confirm a meaning with supplementary means of interpretation. In doing to, they will seek to confirm that apparent clarity accords with “informed” clarity – see Chapter 21.01.

Echoing Para. 11 of the ILC Commentary (above), Para. 18 of the ILC Commentary runs in part: “... the Commission’s approach to treaty interpretation was on the basis that the text of the treaty must be presumed to be the authentic expression of the intentions of the parties, and the elucidation of the meaning of the text rather than an investigation *ab initio* of the supposed intentions of the parties constitutes the object of interpretation. It formulated article [31] on that basis, making the ordinary meaning of the terms, the context of the treaty, its object and purpose, and the general rules of international law, together with authentic interpretations by the parties, the primary criteria for interpreting a treaty. Nevertheless, it felt that it would be unrealistic and inappropriate to lay down in draft articles that no recourse whatever may be had to extrinsic means of interpretation, such as *travaux préparatoires*, until after the application of the rules contained in article [31] has disclosed no clear or unreasonable meaning. In practice, international tribunals, as well as States and international organizations, have recourse to subsidiary means of interpretation, more especially *travaux préparatoires*, for the purpose of confirming the meaning that appears to result from an interpretation of the treaty in accordance with article [31]. The Court itself has on numerous occasions referred to the *travaux préparatoires* for the purpose of confirming its conclusions as to the “ordinary” meaning of the text.”

Similarly, Sinclair commented (1984, 142 italics not added): “... *in practice*,

international tribunals are regularly called upon to assess the significance of *travaux préparatoires*, even if they may in the event conclude that the text of the disputed provision is so clear that no reference to the *travaux préparatoires* is called for.”

It is not permissible to determine that a treaty text is apparently clear without first applying Article 31 as a whole – see Chapter 4.02. Similarly, even when the application of Article 31 results in apparent clarity, one can only determine that such apparent clarity accords with real or “informed” clarity by recourse to those supplementary means of interpretation permitted by Article 32.

4.04 Article 32; supplementary means of interpretation

At a public international level, recourse to supplementary means of interpretation is routine. What supplementary means of interpretation are permissible?

Article 38(1) of the Statute of the International Court of Justice runs in part: “The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:

- (a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting States;
- (b) international custom, as evidence of a general practice accepted as law;
- (c) the general principles of law recognized by civilised nations;
- (d) ... judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.”

In practice, it is difficult to avoid the conclusion that *any* material which could be relevant to the interpretation of a treaty may be admissible at a public international level.

As Sinclair commented (1984, 116): “In any event, it is clear that no would-be interpreter of a treaty, whatever his doctrinal point of departure, will deliberately ignore any material which can usefully serve as a guide towards establishing the meaning of the text with which he is confronted.”

Article 32 of the Vienna Convention expressly includes *travaux préparatoires* (negotiating history) as supplementary means of interpretation. Such material should be defined broadly. Para. 20 of the ILC Commentary begins (*italics added*): “The Commission did not think that anything would be gained by trying to define *travaux préparatoires*; indeed, *to do so might only lead to the possible exclusion of relevant evidence.*”

Apart from gaining nothing, it is unnecessary to define *travaux préparatoires* – because borderline material is most likely to be admissible as “any supplementary means of interpretation”.

Jurisprudence (decisions – from whatever country) and doctrine (the commentaries of learned authors) have long been recognised as evidence of international law itself. As such, this material clearly ranks as supplementary means of interpretation.

The courts of several States (including Australia, Canada, India, the Netherlands, New Zealand, South Africa, the UK and the US) have already found foreign decisions

to be a useful means of interpreting tax treaties – see Chapter 29.

The courts of several States have also already found doctrine to be a useful means of interpreting tax treaties – see Chapter 30.

4.05 Article 33; plurilingual texts

Article 33(1) of the Vienna Convention runs: **“(1) When a treaty has been authenticated in two or more languages, the text is equally authoritative in each language, unless the treaty provides or the parties agree that, in case of divergence, a particular text shall prevail.”**

Article 33(1)’s “equality of texts” approach treats plurilingual texts as equally authoritative expressions of a single treaty. Every effort must be made to reconcile these texts so as to find a common meaning – see Chapter 20.

Chapter 5 Article 31(1): Good faith, equality and reciprocity

5.01 *Pacta sunt servanda*

Article 31(1) of the Vienna Convention begins: “A treaty shall be interpreted in good faith ...”

The good faith principle flows directly from the *pacta sunt servanda* rule – that each signatory State must observe its obligations to perform a treaty. The preamble to the Charter of the United Nations recognises this rule when it refers to “justice and respect for the obligations arising from treaties”. Referring to drafts of the Vienna Convention, Rosenne comments (1966, 223): “It would not be an exaggeration to say that the whole of the draft articles are postulated upon the principle of “good faith,” both as regards the draft articles themselves, and as regards treaties to which the draft articles will become applicable.” Sinclair describes (1984, 119) this rule as “the most fundamental of all the norms of treaty law”.

The third paragraph of the preamble to the Vienna Convention notes: “... the principles of free consent and of good faith and the *pacta sunt servanda* rule are now universally recognised ...” The *pacta sunt servanda* rule appears in codified form in Article 26 of the Vienna Convention.

Article 26 runs (italics added in the text): “*Pacta sunt servanda* Every treaty in force is binding upon the parties to it and must be performed by them *in good faith*.”

The corollary of this fundamental “good faith” principle is a second principle – that no domestic law may relieve a State from its obligation to perform a treaty. This second principle appears in codified form in Article 27 of the Vienna Convention.

Article 27 starts: “*Internal law and observance of treaties* A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty.”

This second principle was described in New Zealand: February 19 1979 *Case D1* (Article 25) when A.J. Lloyd-Martin cited (4 NZTC 60,404) this extract from McNair’s *The Law of Treaties* (1961, 761): “When a State enters into an obligation of an international character, it is not allowed to adduce an inadequacy or incompatibility in its own legal system, or any of its legislative or executive acts, as an excuse for the non-performance of the international obligation. This is a fundamental principle applicable to the international obligations of a State whether arising from an agreement or from the rules of customary law. It is this principle which establishes the primacy of international law over municipal law.”

The fundamental principle that all parties to a treaty must perform it in good faith results in reciprocal obligations; all its parties are under the same reciprocal obligation to perform it in good faith.

The fact that each State must perform a treaty in good faith means that each State must also interpret it in good faith. As Sinclair commented (1981, 119): “If “good faith” is required of the parties in relation to the observance of treaties, logic demands that “good faith” be applied to the interpretation of treaties.”

5.02 Equality and reciprocity

It has long been recognised that, in law, all nations are equal. In his paper *Equality in International Law*, McNair commented (1927, 62): “An international tribunal, or a municipal tribunal when giving effect to the international obligations of the State to which it belongs, pays the same attention to the rights of France as it does to the rights of Costa Rica. And Chief Justice Marshall in 1925, in *The Antelope* ...[10 Wheat. 66], ... said: “No principle of general law is more universally recognised than the perfect equality of nations.” ”

McNair concluded (1927, 77) that equality of States “... is used to denote Equality before the law, equality in the assertion and vindication by law of such rights as a state may have, what I have ventured to call Forensic Equality. In this sense the Equality of States is a normal fact of international jurisprudence; it is a just and necessary principle, and requires no particular comment.”

The equality of nations is enshrined in the Preamble to the Charter of the United Nations when it affirms “... the equal rights of men and women and of nations large and small ...”

The equality of nations, and the contractual and reciprocal nature of a treaty, require each (equal) party to a bilateral treaty to interpret it in accordance with what *both* parties agreed. This is implicit in the good faith requirement in Article 31(1) of the Vienna Convention. As McNair commented (1961, 465): “The performance of treaties is subject to an over-riding obligation of mutual good faith. This obligation is also operative in the sphere of the interpretation of treaties, and it would be a breach of this obligation for a party to make use of an ambiguity in order to put forward an interpretation which it was known to the negotiators of the treaty not to be the intention of the parties.” As Yasseen commented (1976, 22 (in translation) footnote 10 omitted): “... the obligation is to be inspired, in the interpretation of a treaty, by the good faith which should animate the parties if they were themselves called upon to find the meaning of the text which they had drafted.”

Article 33 of the Vienna Convention and its Commentary (see Chapter 20) also confirm that a treaty must be interpreted in accordance with the “one common intention” of all treaty partner States. Article 33 provides that, when a treaty has been authenticated in more than one language (which, in the case of a bilateral tax treaty, will normally be the language(s) of each treaty partner State) each text is equally authoritative.

The view that tax treaty terms should receive a common meaning (reflecting the view of *both* Contracting States) is accepted in Article 3(2) of the 1981 US Model – which provides (see Chapter 27.05) that competent authorities may agree on “a common meaning”.

Similarly, in US: August 13 1992 *Snap-On* (Article 23 and see Chapter 25.12), Horn J. emphasized the US Supreme Court’s holding in *Sumitomo Shoji America, Inc. v. Avagliano* (457 U.S. at 184-85) that the role of the US Supreme Court was (italics added by Horn J.) “... limited to give effect to the intent of the Treaty *parties*. When

the *parties* to a treaty *both* agree on the meaning of a treaty term, the court should normally defer to such interpretation.”

Only if a treaty is interpreted to reflect what *all* its parties agreed can equality and reciprocity between these (equal) parties be ensured. As the US Supreme Court held in *Jordan v. Tashiro* (773 L.ed. 214 at 218 – italics added): “The principles which should control the diplomatic relations of nations, and the good faith of treaties as well, require that their obligations should be liberally construed so as to effect the apparent intention of *the parties* to secure equality and reciprocity between them.” (The next sentence of this quotation is given in Chapter 11.03.)

Katz has commented (1993, 650): “Reciprocity is a governing consideration in the sense of respect of, and fairness to, the contractual interest of the other party.”

So fundamental is reciprocity that Article 55 of the French Constitution makes all treaties conditional upon reciprocity – see France: *February 16 1983 CE* (Article 7).

Similarly, Denmark’s Act No. 74 of March 31 1953 (as amended) only authorises tax treaties to be concluded subject to reciprocity (see Michelsen 1993, 296). A comparable rule exists under Finland’s common law (see Vapaavuori 1993, 317) and under s.108(1) of South Africa’s Income Tax Act (see South Africa: March 10 1992 *ITC 1544* – Article 24).

Reciprocity is particularly necessary as regards tax treaties – because they are generally expressed in reciprocal terms, and indeed may be expressly conditional on reciprocity (see Chapter 13.01). Under reciprocal tax treaty provisions, one State’s rights and obligations are exactly matched by those of its (equal) treaty partner State. Tax treaties typically ensure equality and reciprocity by providing for concessions to be made by either the source State or the residence State. Concessions made by one State when it is, say, the residence State will normally be matched by equal and reciprocal concessions by the other State when *it* is the residence State. Similarly, the concessions to be made by a source State will normally be the same regardless of which State is the source State.

However, when a tax treaty is not expressly conditional upon reciprocity, it may remain obligatory even if no reciprocity exists – see Chapter 12.06 (notably its references to Canada: January 28 1985 *Gladden Estate* and France: March 4 1993 *Reply de Cuttoli*) (both Article 13) and Chapter 13.03 (notably its references to US: October 22 1975 *Burbank* – Article 26).

5.03 The “principle” of reciprocity

The principle that all treaties must be performed (reciprocally) by all States in good faith, and the fact that tax treaties are generally expressed in reciprocal terms, is reflected in the Commentaries on the 1977 and 1992 OECD Models – which refer to a “principle of reciprocity”.

Para. 1 of the Commentary on Article 24 of the 1977 OECD Model (and the 1992 OECD Model) notes that it forbids discrimination on the grounds of nationality – subject to reciprocity. The second sentence of Para. 55 of the Commentary on Article

24 of the 1977 OECD Model (a Para. which has been omitted from the 1992 OECD Commentary) then refers to a “principle of reciprocity”. It ends (*italics added*): “ ... it has always [*sic*] been accepted that such a [most-favoured-nation] clause did not apply in the case of double taxation conventions *because these are essentially based on the principle of reciprocity.*”

Accordingly, a most-favoured-nation clause in a treaty, to the effect that more favourable benefits granted under treaties signed by one State with third States will be available to the treaty partner State, will not cover tax treaties – see Switzerland: *September 12 1945 Zurich Commission* (Article 24) and its *Editorial*.

The 1977 OECD Model’s brief (and transitory) reference to a “principle of reciprocity” casts little light on what this principle is – or on what its effects or consequences are.

Whether “reciprocity” is a “principle” or not, when States conclude a tax treaty they generally undertake equal and reciprocal obligations to avoid double taxation – and are generally allocated equal and reciprocal rights to tax. Accordingly, Para. 55 would have been more illuminating had it ended (*italics added*): “... it has always been accepted that a most-favoured nation clause does not apply in the case of double taxation conventions *because, under these conventions, a State generally only undertakes obligations on the basis that the treaty partner State also undertakes equal and reciprocal obligations.*”

The second sentence of Para. 12 of the Commentary on Article 3(2) of the 1992 OECD Model also describes it as being “based” on “the principle of reciprocity”.

This second sentence (which is also analysed in Chapters 7 and 10) runs (*italics added*): “The context is constituted in particular by the intention [*sic*] of *the Contracting States* when signing the Convention as well as the meaning given to the term in question in the legislation of the *other Contracting State* (an implicit reference to the principle of reciprocity on which the Convention is based).”

Para. 12 sheds a little more light on this “principle of reciprocity”. Para. 12 requires a State interpreting (the context of) a tax treaty term to have regard to the original intention [*sic*] of *both* States – and to the meaning of the term in the *other* State. This requirement is, therefore, virtually identical to the “good faith” requirement in Article 31(1) of the Vienna Convention that each party to a bilateral tax treaty should interpret it in accordance with what *both* parties agreed.

The principles of “good faith”, “equality” and “reciprocity” thus all require bilateral tax treaty terms to be interpreted in accordance with the common intention and understanding of *both* contracting States. This fundamental principle of tax treaty interpretation is discussed in more detail in Chapters 21 and 25.

By stressing the “intention of the Contracting States *when signing the Convention*” Para. 12 also confirms the necessity of determining this original intention and the original meaning of the tax treaty terms. This principle – of contemporaneity – is discussed in Chapters 9, 10 and 18.

5.04 Reciprocity requires treaty partner States to interpret a tax treaty consistently

If the reciprocally-expressed rights and obligations in tax treaties are to be reciprocal in practice, tax treaty terms must be interpreted consistently in all treaty partner States. This consistency can only be achieved by States adopting a uniform interpretative approach – which takes account of the principle that a tax treaty must be interpreted in accordance with the common intention of all its signatories.

Implicitly recognising this, those involved in interpreting tax treaties are now considering, with increasing frequency, how a treaty partner State interprets a tax treaty – see, for example, Chapters 25, 28 and 29.

Indeed, a court may attach such importance to the reciprocity which can only be achieved by both States interpreting a tax treaty consistently, that it may tolerate double non-taxation. Thus Sweden: *December 23 1987 Supreme Court* (Article 13) was clearly influenced by the UK Revenue's view as to the scope of an anti-avoidance provision in the 1968 Protocol to the 1960 UK tax treaty. The Supreme Court held that if it adopted a different view, this would result in the treaty being applied asymmetrically and unreciprocally. Accordingly, it adopted a similar view – even though this resulted in a capital gain avoiding tax in both States.

The fact that courts seek to apply reciprocally-expressed tax treaty terms on a reciprocal basis may lead to unexpected results. For example, the courts of one State may be more willing to hold that treaty “abuse” exists if the treaty partner State also seeks to prevent abuse of its treaties.

Thus Germany: *March 5 1986 BFH* (Article 4) held that s.6 Steueranpassungsgesetz (a German abuse of law provision) could be applied more readily to the 1931 Switzerland tax treaty – because Switzerland had also sought to prevent abuse of its tax treaties by enacting the December 14 1962 Federal Decree (Article 4).

Similarly, the House of Lords (notably Lord Reid) in UK: *March 2 1961 Collico* (Article 10 and see Chapter 16.01) was clearly influenced, in holding that domestic UK legislation overrode a tax treaty, by Ireland's past behaviour – which indicated that it might not object to such an override.

5.05 Reciprocity and equality of effect

The (correct) proposition that each State should seek to interpret a reciprocally-expressed tax treaty term so that it has a uniform *meaning* in each State must be distinguished from the (incorrect) proposition that a tax treaty term should be interpreted so that it has an equal *effect* in each State. The distinction between the two propositions is simple. The former proposition only involves the consistent and uniform interpretation of a tax treaty term itself – regardless of the effect of such interpretation in each State. The latter proposition incorrectly involves interpreting a tax treaty term by reference to its effect in each State under this State's domestic law. However, this distinction can be difficult to draw in practice – see Chapter 12.

Chapter 6 Article 31(1): The textual approach and the parties' intentions

Article 31(1) of the Vienna Convention runs: "General rule of interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

6.01 *The tax treaty text is the best evidence of the treaty partner States' intentions*

One of the three main approaches to treaty interpretation in public international law is the "intentions of the parties" approach (see Chapter 4.01). This approach ascertains the parties' intentions – and then construes the treaty to give effect to such intentions.

Article 31(1) of the Vienna Convention, by omitting an express reference to the parties' intentions, makes clear that treaty terms must be given the meaning which they *do* have (the textual approach) – rather than a meaning which the parties may (or may not) have intended them to have. The best evidence of the treaty partner States' intentions is to be found in the ordinary meaning of the treaty text itself.

In a tax treaty context, particular problems await those who try and implement what they suppose the treaty partner States' intentions were – as this Chapter (which discusses whether *some* meaning must be given to tax treaty terms) and Chapter 12 (which discusses whether this meaning must be *reciprocal*) illustrate. If excessive weight is given to the parties' supposed intentions (by, for example, stressing the contractual nature of a treaty) insufficient weight may then be given to the treaty's actual text.

6.02 *At a domestic level, the textual approach is even more appropriate*

At a public international level, Article 31(1) of the Vienna Convention requires the textual approach to be applied to the interpretation of tax treaties.

At a domestic level, the application of a textual approach to tax treaties is even more necessary – because at this level a tax treaty is also domestic legislation, affecting the rights of taxpayers and having as its primary purpose the avoidance of double taxation (see Chapter 11.01). The treaty partner States' (contractual) intentions are primarily relevant only at a public international level – where what is being interpreted is a (contractual) treaty between States i.e. the rights of States *as between themselves*.

In the context of its criticism of the approach adopted in US: May 5 1982 *Great-West* (Article 7 and see Chapters 6.06 and 6.07), and implicitly recognising the dual status of a tax treaty (see Chapter 1), the 1992 ALI Report comments (46): "Although a treaty has some aspects of a contract between the participating states, it is also the functional equivalent of a statutory enactment as far as the taxpayer is concerned."

Unfortunately, the 1992 ALI Report then continues: "In deciding whether to give effect to the literal language of a treaty, a court should take into account the reasonableness of taxpayers' reliance on that language." As Walton J. observed in UK: March 12 1976 *Avery Jones* (Article 4 – see Chapter 6.03) the proposition that a

“reasonable” interpretation must be correct is unsound. An “unreasonable” interpretation may be the only correct one.

As indicated below, some domestic courts have focused excessively on the fact that a treaty is an agreement between two States – and have then sought (often unsuccessfully) to give effect to what they supposed these intentions were. In the future, Courts are likely to give more weight to the meaning of the text – because the textual approach in Article 31(1) of the Vienna Convention is likely to be increasingly accepted as the general rule of tax treaty interpretation.

6.03 *If possible, tax treaty terms should be construed so that they may have effect*

According to Broom (1939, 362), the “golden rule” in construing written agreements is that, if possible, words should be construed so that they may have effect.

The rule that agreements should be construed so that they may have effect is sometimes referred to in its original Latin: “*ut res magis valeat quam pereat*”.

The ILC Commission on the Vienna Convention considered whether this principle should be included as one of Article 31’s general rules. Para. 6 of the ILC Commentary runs: “The Commission, however, took the view that, in so far as the maxim *ut res magis valeat quam pereat* reflects a true general rule of interpretation, it is embodied in article 27, paragraph 1, which requires that a treaty shall be interpreted *in good faith* in accordance with the ordinary meaning to be given to its terms in the context of the treaty *and in the light of its object and purpose*. When a treaty is open to two interpretations one of which does and the other does not enable the treaty to have appropriate effects, good faith and the objects and purposes of the treaty demand that the former interpretation should be adopted. Properly limited and applied, the maxim does not call for an “extensive” or “liberal” interpretation in the sense of an interpretation going beyond what is expressed or necessarily to be implied in the terms of the treaty. Accordingly, it did not seem to the Commission that there was any need to include a separate provision on this point. Moreover, to do so might encourage attempts to extend the meaning of treaties illegitimately on the basis of the so-called principle of “effective interpretation”. The Court, which has by no means adopted a narrow view of the extent to which it is proper to imply terms in treaties, has nevertheless insisted that there are definite limits to the use which may be made of the principle *ut res magis valeat* for this purpose. In the *Interpretation of Peace Treaties* Advisory Opinion [Footnote 127: *I.C.J. Reports 1950, p. 229*] it said: “The principle of interpretation expressed in the maxim: *ut res magis valeat quam pereat*, often referred to as the rule of effectiveness, cannot justify the Court in attributing to the provisions for the settlement of disputes in the Peace Treaties a meaning which ... would be contrary to their letter and spirit.” And it emphasized that to adopt an interpretation which ran counter to the clear meaning of the terms would not be to interpret but to revise the treaty.”

There have been two notable instances when UK courts have been asked to “give effect” to tax treaty terms.

In UK: March 12 1976 *Avery Jones* (Article 4) Walton J. rejected the taxpayer's argument that the expression "citizen ... of [the UK]" was unknown to UK law and could not be construed as referring to a British subject or a citizen of the UK and Colonies. Had he held otherwise, the treaty phrase "citizen ... of [the UK]" would have had no meaning whatsoever – an untenable position (see Chapter 12.10).

However Walton J., whilst accepting the Revenue's argument, rejected some submissions by their Counsel (Mr. Oliver) commenting (51 T.C. 455): "One of Mr. Oliver's submissions to me, however, went well outside those recorded by the Special Commissioners. He submitted that article XV should be given – in particular the words relating to citizenship – "as much meaning as it needs to have" and that the construction he would place on the words used was "reasonable". These are truly remarkable submissions. On what principle is the Court to decide how much meaning a provision needs to have? And what authority is there that because a construction which a particular person seeks to place on a provision is "reasonable" it must be the correct one? Such propositions have only to be stated to be rejected as unsound. If the present case has to be decided upon any such general propositions, the general propositions applicable are that, as far as it is humanly possible, a document must be construed so as to give effect to every word used by the Parties, and in deciding what the meaning of those words is one must look at the document as a whole to see whether those words occur elsewhere, as, if possible, the same construction should be placed on them in both contexts. Moreover, I think that the Courts would always be very slow to refuse to give any meaning at all to a provision in an agreement made between two governments if any sensible construction at all could be placed on it."

In UK: February 20 1990 *Union Texas* (Article 10) Harman J. commented ([1988] STC 707) that because the 1975 US tax treaty was an agreement "... it should be construed as *ut res magis valeat quam pereat*, as should all agreements."

Those researching this Latin maxim may have difficulty – because it traditionally appears in the middle of the sentence: "*Benignae faciendae sunt Interpretationes propter Simpliciter Laicorum ut Res magis valeat quam pereat; et Verba Intentioni, non e contra, debent inservire*". *Black's Law Dictionary* (Fifth Edition, 145) offers the following translation: "Constructions [of written instruments] are to be made liberally, on account of the simplicity of the laity [or common people], *in order that the thing [or subject matter] may rather have effect than perish* [or become void]; and words must be subject to the intention, not the intention to the words. 2 Bl. Comm. 379".

This full sentence highlights the two rules of most general application in construing written agreements: namely that they should be construed (firstly) so that they may have effect and (secondly) so that they give effect to the intentions of the parties.

Union Texas involved Article 10(2)(a)(i) of the 1975 US tax treaty (as amended). This provides that a US corporation owning at least 10% of the voting stock of a UK resident corporation shall be entitled to (italics added) "*a tax credit equal to one-half of the tax credit to which an individual resident in the UK would have been entitled to had he received the dividend*" subject to a deduction of 5% on the aggregate of the

dividend and “*the tax credit paid to such corporation*”.

In the High Court, Harman J. rejected Union Texas’ first argument that *a* tax credit to which it was entitled was not *the* (same) tax credit which was subject to a deduction of 5% withholding tax. He held that *a* tax credit in Article 10 of the treaty was “*the tax credit*” generally available (under s.86 Finance Act 1972) to shareholders receiving dividends from UK companies. This view was essentially upheld on appeal.

Had Harman J. held otherwise, the phrase “*a tax credit*” in the treaty would have had no meaning whatsoever. Harman J. held ([1988] STC 707): “If these “tax credits” are not “Section 86 tax credits”, they are an invention of the negotiators of this agreement; that is improbable. If such a reading of the document results in a provision intended on its face to produce a deduction having no such effect, that is effectively to cause this part of the double tax agreement to “perish” and the court should lean against such a result.

I also recall, though remembering that they are uttered in the context of construing a Taxing Act, the words of Lord Dunedin quoted in the case stated from *Whitney v IRC* [1926] AC 37 at 52, 10 TC 88 at 110. The words I bear in mind are “A statute is designed to be workable and the interpretation thereof by the Court should be to secure that object”. I agree with the Special Commissioner that one should believe that the relevant words of art 10 were intended by the high contracting parties to have some meaning, and I add that the court should try and discover a workable meaning if it can.”

Harman J. then commented ([1988] STC 707, italics added): “ ... this double tax agreement is an agreement. It is not a taxing statute, although it is an agreement about how taxes should be imposed ... In my judgment, the precise approach to language applicable to a taxing statute, when the taxpayer is entitled to claim that he or it should only be taxed by plain words, so that if there is doubt whether tax is due because the taxing words are inapt to cover some source of money the taxpayer is not taxable on it, has no application in this case.”

Despite this comment, Harman J. did apply a “precise approach” in upholding Union Texas’ second argument – that even if 5% withholding tax was due, it was only due on the actual net sum *paid* to Union Texas (i.e. net of withholding tax). Harman J. held that the word “paid” meant what it said – it did not mean “payable”.

This second argument also succeeded in the Court of Appeal – but *it* held that although the word “paid” had to mean “payable”, the amount payable was the net amount paid. Both these holdings were clearly inconsistent with the parties’ intentions – which were not even mentioned by either Court.

Whilst other aspects of Harman J.’s decision are open to criticism (see the *Editorial on Union Texas in The International Tax Treaties Service*) his approach to tax treaty interpretation is commendable. It can be summarised as follows. When the language in the treaty can be “perfectly readily applied” it will be ([1988] STC 708c). Only when there is some doubt as to its meaning “should a court try and discover a workable meaning if it can” ([1988] STC 707g).

Under this approach, treaty terms will be interpreted to mean what they say. One implication of this approach is that when treaty terms favour taxpayers but conflict with the intentions of the Contracting States, these States must bear the consequences of their own inadequate drafting. This may put a taxpayer in a favourable “heads the taxpayer wins, tails the Revenue loses” situation – because a court must always take account of a tax treaty’s primary purpose of avoiding double taxation (see Chapter 11.01).

6.04 Words should not be construed simply to give effect to the parties’ intentions

UK: March 1 1982 *Exxon* (Article 4) demonstrates the most unwelcome lengths to which a UK court has gone in seeking to give effect to the parties’ intentions – despite the ordinary meaning of the tax treaty words.

The issue in *Exxon* was whether the residence definitions in Article II(1)(f) of the 1945 US tax treaty should apply to the second sentence of Article XV of this same treaty. (These provisions are explained below.) If so, it was accepted that this second sentence could have no effect as regards US taxes. However Mr. Potter (*Exxon*’s Counsel) argued that this second sentence might have some effect as regards UK taxes.

As Goulding J. commented (56 T.C. 252): “He could only do so by postulating a body which was at once an entity created or organised in the US and a juridical person created under the laws of the UK, and therefore both a US corporation and a UK corporation under Article II of the Convention. I do not believe that, on a proper interpretation of the language of the Convention, such a centaur is conceivable, and, even if it is, I am not altogether convinced that it would carry Mr. Potter home. I must, I think, accept Mr. Nolan’s contention for the Crown that no possible application of the second sentence of Article XV has been demonstrated in argument, assuming the residence definitions to be imported into it.”

Accordingly, Goulding J. held that the second sentence of Article XV of the 1945 US tax treaty could have no possible application or effect (even reciprocally – see Chapter 12.11) if Article II(1)(g)’s residence definitions were imported into it. However, he obviously felt uneasy about this. He commented (56 T.C. 253): “A more respectable support for Mr. Potter, and one that at one point almost persuaded me, is that in this difficult area of discussion it is very hard to say with certainty that a particular provision cannot in any circumstances take effect. Sufficient demonstration of the limitations of professional foresight is afforded by the Crown’s change of mind about the comparable argument on the first sentence of Article XV. However, after the full consideration by counsel and those instructing them of the controversy in the present case, I fear it would be merely obscurantist of me to suppose there may be some undiscovered field in which the second sentence of Article XV, interpreted according to the residence definitions, could successfully operate.”

Nevertheless, having decided that the second sentence of Article XV could have no application at all if Article II(1)(g)’s residence definitions were imported into it, Goulding J. commented (56 T.C. 252, footnotes omitted): “At this point two

alternatives are open to me. That commended by Mr. Potter is to continue to read Article XV according to the plain natural meaning of its words and to simply accept the consequence that the second sentence of the article has, either probably or certainly, failed to achieve whatever purpose its framers intended. ... The other course, urged on me by Mr. Nolan, is to say that the broad policy behind the second sentence is clear, namely to deny exemption to dividends or interest paid to an American company by a subsidiary trading and controlled in this country and merely incorporated in a transatlantic jurisdiction. I am then entitled, says Mr. Nolan, to read the sentence in a way, even if not the most natural way, that will give it some practical effect rather than none. He refers me to Lord Diplock's speech in ... [UK: *Fothergill* – see Chapter 3.13] [1981] AC 251 at 280 [when Lord Diplock noted an increasing willingness to give a purposive construction].”

Unfortunately, Goulding J. concluded (56 T.C. 253): “I think, on a general consideration of the scheme of the Convention, that Mr. Nolan is right in saying that the intended purpose of the second sentence of Article XV can be discerned. Accordingly, although it seems to me that upon the plain meaning of the words used, the expression “resident of the other Contracting Party” in that sentence does import the residence definitions (which V.C. Pennycuick thought almost too clear for words in relation to the comparable phrase in the first sentence) I must nevertheless give it a different construction, so that it does not fail of effect. In coming to this conclusion I bear in mind that the words of the Convention are not those of a regular Parliamentary draftsman but a text agreed on by negotiation between the two contracting governments. Although I am thus constrained to do violence to the language of the Convention, I see no reason to inflict a deeper wound than necessary. In other words, I prefer to depart from the plain meaning of language only in the second sentence of Article XV, and I accept the consequence (strange though it is) that similar words mean different things in the two sentences.”

It is unfortunate that Goulding J. sought to interpret the second sentence of Article XV in accordance with “the broad policy behind it” and its “intended purpose” – especially as this also forced him to do violence to the language of the Convention. He could have avoided such violence, and his unfortunate holding that similar words meant different things in two succeeding sentences of a single Article, had he simply applied the actual words of the Convention. He could have held that, pursuant to the first few words of Article II(1), *the context* clearly required that the treaty definitions not apply. This context (and *Exxon*) are discussed in Chapter 7, especially in relation to UK: June 23 1972 *Strathalmond* (Article 4 and Chapter 7.12) – which also adopted a textual approach and ignored the intentions of the parties.

6.05 German and UK courts sometimes apply the ordinary meaning of tax treaty terms

Germany: October 9 1985 *BFH* and UK: February 9 1990 *Commerzbank* (both Article 7) both hold that the ordinary meaning of tax treaty terms must be applied and given effect to – even though the contracting States only intended these terms to apply

to a different situation, even though the tax treaty then applied to a situation which they did not envisage, and even though substantial benefits thereby accrued to taxpayers. However, Germany: *January 20 1993 BFH* conflicts squarely with *October 9 1985 BFH* – see below. These three decisions all involved tax treaty provisions very similar to those at issue in a fourth decision: US: May 5 1982 *Great-West* (Article 7 and see Chapter 6.06) – which adopted an extra-textual, “intentions of the parties” approach.

These provisions were intended to apply to a particular situation caused by a feature of US tax law which has never had a counterpart in Germany or the UK. This feature is that, under s.861 IRC, the US seeks (normally unsuccessfully) to impose a “second” withholding tax on income deemed to have a US source. Such income includes dividends and interest paid by a foreign corporation to a foreign shareholder if 50% or more of the paying corporation’s income is effectively connected with the conduct of a US trade or business.

To preclude the levying of such a “second” US withholding tax, the 1954 Germany/US tax treaty and the 1945 UK/US tax treaty provided that dividends and interest paid by a German/UK corporation shall be exempt from [the second] US [withholding] tax where the recipient is not a resident or corporation of the US.

However, to cover the possibility of Germany or the UK enacting a comparable feature, these tax treaty provisions were expressed in reciprocal terms. Thus, Article XIV(2) of the 1954 US tax treaty at issue in *October 9 1985 BFH* and *January 20 1993 BFH* ran: “Dividends and interest paid by a US corporation shall be exempt from tax by the Federal Republic where the recipient is not a resident or company of the Federal Republic.” *Commerzbank* involved a very similar treaty provision, as indicated below.

As phrased, however, these provisions could apply to wholly different situations – to the substantial advantage of some taxpayers. Both *October 9 1985 BFH* and *Commerzbank* held that they should nevertheless be given their actual and literal meanings – even though the contracting States could never have intended this.

In *October 9 1985 BFH* (Article 7 and see Chapters 17.02 and 27.13) a US corporation (a commercial bank with its head office in the US) had a German branch. This German branch was paid interest by borrowers which were “US corporations”. Such borrowers were neither “a resident” nor “a company” of Germany – even though, provocatively, they were often German branches of US corporations. The bank argued that Article XIV plainly exempted this interest income from tax by Germany.

The BFH upheld this argument. The actual words of Article XIV, which gave no indication of its purpose, had to be read literally.

The BFH also considered that its literal interpretation was consistent with Article XIV being reciprocal – even though *Great-West* had interpreted Article XIV quite differently, so that the chances of Article XIV actually being applied reciprocally were more than unlikely. Read literally, Article XIV(1) precluded the US from taxing interest income effectively connected with a US branch of a German bank in a reverse situation to the one at issue – so that Germany could then tax this interest. The BFH’s assumption that Article XIV could (and should) be interpreted in this way conflicted

squarely with the prior decision in *Great-West*.

The BFH also considered that its interpretation of Article XIV(2) could be justified because it might avoid double taxation. If interest income was regarded as US source income, the US would not give a credit for any German tax imposed on it – because the US only gives a credit for tax paid on foreign source income.

However, Germany: *January 20 1993 BFH* reached a different conclusion to *October 9 1985 BFH*; it interprets Article XIV(2) in line with its original purpose of only precluding the extraterritorial taxation of dividends (in common with Article 10(5) of the OECD 1977 Model which *January 20 1993 BFH* cited – see Chapter 26.01) and interest. In effect, it adopts reasoning very comparable to the criticism of *October 9 1985 BFH* in its *Editorial in The International Tax Treaties Service*. It holds that the interest income represents part of the industrial or commercial profits of a German branch of a US corporation, which profits are taxable in Germany under Article III of the treaty. The willingness of *January 20 1993 BFH* to disregard the plain meaning of the terms of Article XIV(2) may have stemmed from a desire to avoid the non-taxation of the branch's interest spread (i.e. its profit) in Germany – see Chapter 11.03.

No such desire affected the quality of Mummery J.'s judgment in UK: February 9 1990 *Commerzbank* (Article 7) involving Article XV of the 1945 UK/US tax treaty (as amended in 1966) – which is very similar to Article XIV of the 1954 Germany/US tax treaty.

Article XV began: “Dividends and interest paid by a corporation of one Contracting Party shall be exempt from tax by the other Contracting Party except where the recipient is a citizen, resident or corporation of that other Contracting Party.”

In *Commerzbank*, *Commerzbank AG* (incorporated and resident in Germany) and *Banco do Brasil SA* (incorporated in Brazil) had UK branches. These UK branches were paid interest by corporations of the US. Neither UK branch (of, respectively, a German and a Brazilian corporation) was either a citizen or a resident or a corporation of the other Contracting Party (the UK).

The banks argued that Article XV plainly exempted this interest income from tax by the other Contracting Party, the UK. Material to opposite effect, notably a joint statement made by the UK and US competent authorities (see Chapter 27.17) and the decision in *Great-West*, should be disregarded.

Mummery J. upheld the banks' arguments. In an approach detailed in Chapter 3.14, he held ([1990] STC 303 and 304): “(1) The words of art XV, both on their own and in the context of the convention as a whole, are clear. The natural and ordinary meaning of the words is that art XV exempts from UK tax interest which has been paid by US corporations. ... (2) The construction of art XV advanced by the banks does not give rise to manifestly absurd or unreasonable consequences. Any surprise that there may be in finding that a German or Brazilian bank can claim an exemption under a convention negotiated between the UK and the USA is substantially lessened by the fact that the exemption in question is a limited one, applying only to dividends and interest which have a source in one of the contracting parties. ... (3) I can find no sufficient indication

in the purpose of the convention or in its surrounding circumstances or in provisions in articles other than art XV to qualify the clear words.”

The approach evidenced by these dicta by Mummery J. are in harmony with the Vienna Convention’s textual approach to treaty interpretation and, far from being criticised (see Chapter 3.14), should be applauded. Whether Mummery J. would have reached the same decision had the criticisms of *October 9 1985 BFH* in its *Editorial in The International Tax Treaties Service* been argued before him is a matter of conjecture.

6.06 US courts sometimes overstress the importance of the parties’ intentions

In the US, the importance of a textual approach to legislation has often been stressed. As Mr. Justice Holmes commented (1899, 419): “We do not enquire what the legislature meant; we only ask what the statute means.”

Nevertheless, US courts have often attached importance to giving effect to the supposed intentions of the parties to a treaty – because they have focused on a treaty as a contract between two States. Thus in *Factor v. Laubenheimer*, a 1933 decision not involving tax treaties, the US Supreme Court commented (290 U.S. 276, 293): “In choosing between conflicting interpretations of a treaty obligation, a narrow and restricted construction is to be avoided as not consonant with the principles deemed controlling in the interpretation of international agreements. Considerations which should govern the diplomatic relations between nations, and the good faith of treaties, as well, require that their obligations should be liberally construed so as to effect the apparent intention of the parties to secure equality and reciprocity between them.”

However appropriate such a (contractual) approach may be as regards treaties at a public international level – where, in any event, Article 31(1) of the Vienna Convention and (possibly, see below) US law mandates a “textual” rather than an “intentions” approach – it may be less than appropriate as regards tax treaties at a domestic level. This is because of a tax treaty’s dual status – see Chapter 1. A tax treaty is not just a contract between two States – typically, it is also domestic legislation affecting the rights of taxpayers.

Nevertheless, the fact that US courts often focus on the parties’ intentions need not always disadvantage taxpayers.

For example, the comment in *Factor v. Laubenheimer* cited above was approved in relation to tax treaties by US: April 11 1983 *Burghardt Estate* (Article 3; 80 T.C. 708 Footnote 10) and December 8 1986 *Mudry* (Article 3; 86-2 USTC 86,290). Both these decisions accepted taxpayers’ arguments that “specific exemptions” granted to them under estate tax treaties should also cover “unified tax credits” given under subsequent legislation – see Chapter 10.11.

Numerous other US decisions have stressed the importance of giving effect to the intentions of the parties to a tax treaty – but it is difficult to avoid the conclusion that an approach based on the supposed intentions of the parties is more fraught with dangers than a textual approach. For example, in US: July 8 1957 *American Trust*

(Article 4), Orr J. in the Ninth Circuit based his judgment on what he believed to be the intent of the parties – see Chapter 12.02. In US: April 29 1963 *Maximov*, Clark J. in the Second Circuit also based his judgment on what he believed to be the intent of the parties – and reached an opposite conclusion (see Chapter 12.03). Clark J. commented (299 F.2d 568, italics added): “The basic aim of treaty interpretation is to ascertain the intent of the parties who have entered into agreement, in order to construe the document in a manner consistent with that intent. *Rocca v. Thompson*, 223 U.S. 317, 331-332, 32 S.Ct. 207, 56 L.Ed. 453; Restatement, The Foreign Relations Law of the United States Section 129 (Tent.Draft No. 3, 1959). *And to give the specific words of a treaty a meaning consistent with the genuine shared expectations of the contracting parties, it is necessary to examine not only the language, but the entire context of agreement.*”

This italicised sentence was approved by Rives J. in US: September 2 1964 *Johansson* (Article 4; 336 F.2d 813) and by Quealy J. in US: August 5 1971 *Aiken* (Article 4; 56 T.C. 933). In contrast to *Burghardt Estate* and *Mudry*, both these decisions denied taxpayers’ arguments that they qualified for treaty benefits.

In US: May 5 1982 *Great-West* (Article 7) Kashiwa J., holding against the taxpayer, based his judgment on his premise that (678 F.2d 183): “... the courts have long recognised treaties must be construed so as to enforce the intent of the contracting parties.”

Kashiwa J. had to interpret Article XII(1) of the 1942 Canada tax treaty, as amended in 1951. Article XII(1) ran: “Dividends and interest paid by a corporation organized under the laws of Canada to a recipient, other than a citizen or resident of the USA or a corporation organized under the laws of the USA, shall be exempt from all income taxes imposed by the USA.”

Great-West, a life assurance company organized under the laws of Canada, had a US branch. This branch was paid interest by “corporations organized under the laws of Canada”. This recipient branch (of a Canadian company) was not a citizen nor a resident of the USA, nor a corporation organized under the laws of the USA. It argued that Article XII(1) clearly exempted this interest income from all US income taxes.

Kashiwa J. held that the parties’ intentions should override Article XII(1)’s clear words. He commented (678 F.2d 188): “... the ultimate question remains what was intended when the language actually employed in Article XII was chosen, imperfect as that language may be.”

He continued (678 F.2d 188): “... that language, when understood in light of the treaty’s history and explanatory provisions, effected only a waiver of US taxes imposed solely through the deemed sourcing provisions on those not present in the US.”

6.07 US: the need to focus on the ordinary meaning of tax treaty terms

Kashiwa J. relied excessively upon unilateral US interpretative material – see Chapter 25.09. This may have led him to focus almost exclusively on the supposed intentions of *one* of the treaty partner States (the US, unsurprisingly) rather than on the ordinary

meaning of the words of the treaty text. This approach is clearly inconsistent with the Vienna Convention approach, as the 1992 ALI Report has recognised.

The 1992 ALI Report recommends that the “intentions of the parties” approach in *Great-West* should be used “extremely sparingly”. It comments (46): “In effect, the court in *Great-West Life Assurance* found that the negotiators of the treaty made a mistake in failing to foresee how the language they negotiated might apply. The court reached the result which it believed the parties would have reached had they focused on the facts before the court. This approach to interpretation, while representing the least of evils in a difficult situation, should be used extremely sparingly. [Footnote 152: This approach is squarely inconsistent with the rules of the Vienna Convention.]”

Perhaps because the 1992 ALI Report accepts that Kashiwa J.’s approach represents “the least of evils” (even though it is “squarely inconsistent with the rules of the Vienna Convention”) its Recommendation 1 runs (45, italics added): “1. The express language of an income tax treaty is to be applied in accordance with its terms *unless it is clear that this would frustrate the mutual expectations of the countries which entered into the treaty.*”

Kashiwa J.’s approach may have resulted from misreadings of the Supreme Court judgment in US: April 29 1963 *Maximov* (Article 4 and see Chapter 12.03) – paradoxically, a decision cited by Kashiwa J. as support for his approach.

In fact, Justice Goldberg’s Supreme Court judgment in *Maximov* stressed the importance of focusing on a tax treaty’s words – and dismissed a contention based on the parties’ supposed intentions. He held (10 L Ed 2d 188, italics added): “*The immediate and compelling answer to this contention is that, as already noted, the language of the Convention itself not only fails to support the petitioner’s view, but is contrary to it.*” He continued, in a much mis-quoted passage: “Moreover, it is particularly inappropriate for a court to sanction a deviation from the clear import of a solemn treaty between this Nation and a foreign sovereign, when, as here, there is no indication that *application of the words of the treaty according to their obvious meaning effects a result inconsistent with the intent or expectations of its signatories.*”

Justice Goldberg’s approach is thus based on “the language of the Convention” and the “application of the words of the treaty according to their obvious meaning”. This approach mirrors that adopted in Article 31(1) of the Vienna Convention.

However, Justice Goldberg’s judgment in *Maximov* has often been quoted by US judges as support for an approach for which he might not have had much sympathy. The italicised words at the end of the extract from Mr. Justice Goldberg’s speech above were quoted out of context by, amongst others, the Supreme Court in *Sumitomo Shoji America, Inc. v. Avagliano* (L Ed 2d 765 at 770; 457 U.S. 176 at 180).

In February 28 1989 *Stuart* (Article 26) Justice Scalia in the Supreme Court noted this error – and drew attention to the need to stress the words preceding Justice Goldberg’s italicised words, namely that it was: “particularly inappropriate” for a court “to sanction a deviation from the clear import of a solemn treaty ...”

In *Stuart*, Justice Scalia commented (103 L ed 2d 408): “In *Maximov*, confronted

with an argument appealing to the “intent or expectations” of the signatories, we responded that “[t]he immediate and compelling answer to this contention is that ... the language of the Convention itself not only fails to support the petitioner’s view, but is contrary to it.” *Maximov v. US*, 373 U.S. 49, 54 (1963). We then continued: “Moreover, it is *particularly* inappropriate for a court to sanction a deviation from the clear import of a solemn treaty ... when, as here, there is no indication that application of the words of the treaty according to their obvious meaning effects a result inconsistent with the intent or expectations of its signatories.” *Ibid.* (emphasis added). The import of the highlighted adverb [*particularly*] is, of course, that it would be inappropriate to sanction a deviation from clear text *even if there were* indications of contrary intent. Our *Sumitomo* dictum separated the last clause of this quotation from its context to support precisely the opposite of what it said. Regrettably, that passage from *Sumitomo* is already being quoted by lower courts as “[t]he general rule in interpreting treaties”. *Rainbow Navigation, Inc. v. Department of Navy*, 686 F Supp 354, 359, n. 25 (DC 1988).”

US: August 13 1992 *Snap-On* (Article 23) provides further judicial support for a textual approach. In *Snap-On*, Horn J. held (26 Cl.Ct. 1066): “This court agrees with Justice Scalia’s interpretation in the *Maximov* case. ...

As stated by Justice Scalia, this court believes that the language of the agreement is the best evidence of the intent of the parties and of the purpose of the treaty.”

This approach is wholly consistent with Article 31(1) of the Vienna Convention.

Chapter 7 The ordinary meaning of tax treaty terms in their context

Article 31(1) of the Vienna Convention runs: “*General rule of interpretation*

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”

7.01 Context and Article 31 of the Vienna Convention

Article 31(1) of the Vienna Convention provides that treaty terms are to be given their ordinary meaning “in their context”. Article 31(2) of the Vienna Convention provides that the “context” shall consist of the treaty’s text (including its preamble and annexes), and any contemporaneous agreements (between all the parties) or instruments (by one or more parties but accepted by all the parties as an instrument related to the treaty) made in connection with the conclusion of the treaty.

Article 31(2) thus defines “context” to include only a treaty’s text and contemporaneous agreements or instruments – see Chapter 14.

By stressing that the terms of the treaty must be considered in their context, and by stressing that this context includes the whole of the treaty (as well as any comparable contemporaneous material) Article 31 emphasizes that treaty terms must not be considered on their own, isolated from their context. As Sinclair commented (1980, 127): “The text of a treaty must of course be read as a whole. One cannot simply concentrate on a paragraph, an article, a section, a chapter or a part.” Tax treaty terms must, therefore, be considered in relation to the entire tax treaty in which they appear – i.e. in their tax treaty context. This approach is little different from “the modern principle of construction” of domestic statutes described by Driedger (1983, 87, italics added): “Today there is only one principle or approach, namely, the words of an Act are to be read *in their entire context* and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.” As Willis commented (1938, 6): “No one needs *Maxwell* or *Craies* to tell him that words, like people, take their colour from their surroundings.”

7.02 The ordinary meaning of tax treaty terms in their tax treaty context

The fact that tax treaty terms must be interpreted in their tax treaty context has long been recognised. For example, Mitchell B. Carroll described (1935, 588) tax treaty terms as being expressed in “international tax language”. Nearly sixty years ago, he recognised that tax treaty terms can only be given their ordinary meaning if their *tax treaty* context, as well as the tax treaty’s object and purpose, are considered.

Mitchell B. Carroll’s description was elaborated on in the House of Lords in UK: July 16 1959 *Ostime* (Article 7) when Lord Radcliffe commented (38 T.C. 51, italics added): “Bilateral agreements for regulating some of the problems of double taxation began, at any rate so far as the UK was concerned, in 1946. The form employed, and for obvious reasons similar forms and similar language are employed in all agreements,

is derived, I believe, from a set of model clauses proposed by the fiscal commission of the League of Nations. The aim is to provide by treaty for the tax claims of two governments both legitimately interested in taxing a particular source of income either by resigning to one of the two the whole claim or else by prescribing the basis on which the tax claim is to be shared between them. For our purpose it is convenient to note that *the language employed in this Agreement is what may be called international tax language* and that such categories as “enterprise”, “industrial or commercial profits” and “permanent establishment” have no exact counterpart in the taxing code of the UK.”

As indicated in Chapter 29, Lord Radcliffe’s confirmation that tax treaty language is an “international tax language”, certain terms of which have no exact counterpart in domestic tax law, was approved in Australia: August 22 1990 *Thiel* (Article 7) in the Full Federal Court (by Sheppard J.; 89 ATC 4,036) and in the Full High Court (by Dawson J.; 90 ATC 4,722 and 4,723), in Australia: June 11 1993 *Case 23/93* (Article 5, 93 ATC 296), in India: June 17 1983 *Visakhapatnam* (Article 5; 144 ITR 157), in Rhodesia: August 12 1966 *Tetra Pak* (Article 7; 28 SATC 215) and in South Africa: August 19 1975 *Downing* (Article 5; 37 SATC 256).

“International tax language” in tax treaties should normally be interpreted by adopting an autonomous approach – which recognises that tax treaty terms must be interpreted in their tax treaty context. Indeed, there is no alternative to an autonomous interpretation of those tax treaty terms which have their genesis in tax treaties and which have no analogues in many States’ domestic laws.

Similarly, there may be no alternative to an autonomous interpretation of terms in a tax treaty where the sole text (in the case of the 1982 Italy/Yugoslavia tax treaty), or the text which is to prevail in the case of a divergence of interpretation (in the cases of the 1979 Argentina/Italy and 1991 Netherlands/Sweden tax treaties), is expressed in a language different to that in which each signatory State’s tax laws are expressed.

Three of the most fundamental concepts in the 1977 and 1992 OECD Models use international tax language. These three concepts are an “enterprise” (a frequent term – see van Raad 1993), Article 4’s concept of a “sole” residence State (which is determined by Article 4’s “tie-breaker” provisions when a person is resident in more than one State under domestic laws) and the extensively defined concept of a “permanent establishment” (and its slightly differing analogue, a “fixed base”).

These Models contain many other examples of tax treaty terms using international tax language. “(Business) profits” (Article 7), “profits from the operation of ships or aircraft” (Article 8), “(associated) enterprises” (Article 9) and those having a “special relationship” (Articles 11(6) and 12(4)) are all tax treaty terms or concepts. “Beneficial owner” (Articles 10, 11 and 12) is a term not recognised in many (civil law) OECD States. “Interest” (Article 11) should receive an autonomous tax treaty meaning as, in the future, may dividends (Article 10) – see Chapter 8.11. Following the suggestions in Paras. 79 and 102(b) of the 1985 OECD *Hiring-out of Labour* Report (see Chapter 23.10), the term “employer” probably also has a “tax treaty” meaning – which, under

(new) Commentary on the 1992 OECD Model, includes the *user* of (temporary) staff employed by an agency and excludes a “nominal” employer (see US: Rev. Rul. 74-330 and Rev. Rul. 74-331 – both Article 15). “Entertainers” and “sportsmen” (Article 17) can also now be regarded as tax treaty terms (see Chapter 9.03), as can a “student or business apprentice” (Article 20).

The growing importance of international tax language is evidenced by the emergence of international tax dictionaries. In 1946 the IBFD published such a dictionary in the first Volume of its *Bulletin*. In 1988 it published a much expanded version, *The International Tax Glossary* – which has since been revised and re-published.

7.03 *The ordinary meaning of tax treaty terms*

Despite the emergence of an “international tax language”, ordinary domestic definitions are often appropriate in a tax treaty context. As Lenz commented (1960, 300): “It is, in theory, preferable to determine the exact meaning of a term used in an agreement according to everyday language instead of referring to domestic law, for this will even enable two States, the fiscal legislations of which differ, to accept the identical meaning of the terms in question.”

For example, US: Rev. Rul. 76-19 and LR 80-36-081 (both Article 20) each hold that when the term “business apprentice” is not specifically defined in a tax treaty “it must be given its common and ordinary meaning”.

Similarly, ordinary dictionary definitions have often been cited in a tax treaty context – either directly, or indirectly by the judge citing another judgment which itself cites dictionary definitions. Some direct citations follow.

In Canada: February 25 1975 *Specht* (Article 18) Collier J. commented (75 DTC 5075): “The word “pensions” as used in the Convention should, I think, be liberally interpreted. In that regard one of the definitions of “pensions” in *The Shorter Oxford English Dictionary* (3rd ed. rev.) is, I consider, applicable to the facts in this case and to Article VIA [of the 1942 US tax treaty].”

In Canada: September 28 1982 *Melford* (Article 7) Grant D.J. referred (80 DTC 6076) to the definitions of “industrial” and “commercial” in *The Shorter Oxford English Dictionary* (2 ed. 1970) and held that a guarantee fee earned by a bank was an industrial or commercial profit – see Chapter 9.

In Canada: November 8 1993 *Crown Forest* (Article 4) Muldoon J. in the Trial Division focused on the words “by reason of ... any other criterion of a similar nature” in Article IV of the 1980 US tax treaty (which is similar to Article 4(1) of the 1977 OECD Model). He cited definitions of “reason” in *Black’s Law Dictionary* and *The Oxford English Dictionary* and commented (92 DTC 6310): “... the presumably deliberate employment of the word and concept of “reason” surely does not ordain any slavishly mechanistic, unthinking application of the criteria of article IV.1 in their narrow, literal or exclusive senses, but rather a process of deducing inferences from the stated criteria so as to determine whether or not they apply directly or indirectly as the, or a, basis for liability to tax, which is agreed to be the generating of income

effectively connected to the conduct of a trade or business in the USA. *Petit Larousse Illustré*, 1984, and Harrap's *New Standard French & English Dictionary* lead precisely to the same interpretation of the equivalent expression "*en raison de*" employed in the French-language version of the Convention article IV.1."

In New Zealand: February 13 1987 *Case J41* (Article 4) counsel referred (9 NZTC 1,243) to the *Shorter Oxford English Dictionary* and *Webster's New Twentieth Century Dictionary* to ascertain the meaning of an "available" home.

In New Zealand: February 7 1992 *Wise* (Article 15) Neazor J. considered (14 NZTC 9,042) the definition of a "branch" in *Black's Law Dictionary*.

In Rhodesia: August 12 1966 *Tetra Pak* (Article 7) Beadle C.J. considered (28 SATC 217) the definitions of "commercial" in the 1933 *Oxford English Dictionary*. He preferred a wide definition to a narrow one.

In South Africa: May 25 1990 *ITC 1503* (Article 8) Melamet J. considered (53 SATC 347) the *Shorter Oxford English Dictionary* in relation to "derive" and the *Stroud Judicial Dictionary* in relation to "revenue".

In US: November 1 1946 *Kimball* (Article 18) Arundell J. ascertained (6 T.C. 540) the meaning of the word "pension" in *Webster's New International Dictionary*.

US: Rev. Rul. 74-541, LR 81-41-069 and LR 81-47-148 (all Article 12) referred to *Webster's Third International Dictionary of the English Language Unabridged (1971)* in holding that film strips and video-tape recordings were not comprised in the term "motion picture".

The usefulness of these dictionary definitions demonstrates that, in many cases, they may well reflect the meaning of a tax treaty term *in its tax treaty context* better than definitions in one State's tax legislation – see Chapter 7.12.

7.04 Context and Article 3 of the OECD Models

The word "context" also appears in Article 3 of the 1977 and 1992 OECD Models – which provides that treaty or domestic definitions are to apply "unless *the context otherwise requires*" (italics added). This phrase appears at the beginning of both Article 3(1) and Article 3(2) – just as it did in the 1963 OECD Draft.

Thus, Article 3(1) of the 1977 and 1992 OECD Models provides: "(1) In this Convention, unless the context otherwise requires ..." various *treaty* definitions shall apply.

Similarly, Article 3(2) of the 1977 and 1992 OECD Models provides that, unless the context otherwise requires, *domestic* tax definitions shall govern the meaning of undefined terms. It runs (italics added): "As regards the application of the Convention by a Contracting State any term not defined therein shall, *unless the context otherwise requires*, have the meaning which it has under the law of that State concerning the taxes to which the Convention applies."

Lenz has described (1960, 296) Article 3(2) as a general "renvoi" clause.

Article 3(1) of both the 1979 UN Model and the 1981 US Model are comparable to Article 3(1) of the 1977 and 1992 OECD Models.

Article 3(2) of the 1979 UN Model is also comparable to Article 3(2) of the 1977 and 1992 OECD Models – but Article 3(2) of the 1981 US Model is somewhat different. The main difference is that Article 3(2) of the 1981 US Model includes, after the words “unless the context otherwise requires”, the words “or [unless] the competent authorities agree to a common meaning pursuant to Article 25 (Mutual Agreement Procedure) ...” This US attempt to endow competent authorities with quasi-legislative powers raises issues which are discussed in Chapter 27.05.

7.05 The meaning of “the context” in Article 3 of the OECD Models

Article 3(1) of the 1977 and 1992 OECD Models provides that its *treaty* definitions are not to apply where “the context otherwise requires”. Similarly, Article 3(2) provides that *domestic* definitions of terms which are not defined in the treaty are not to apply where “the context otherwise requires”.

Because the words “the context” occur twice in the same Article, they should be given the same meaning in each case. This meaning can only be “the context” of the tax treaty as a whole – despite views to the contrary in US: Rev. Rul. 80-243 (Article 7 and see Chapter 10.06).

Rev. Rul. 80-243, which involves the 1945 UK “Old Convention” and the 1985 UK “New Convention”, runs in part (*italics added*): “Article II(3) of the Old Convention and Article 3(2) of the New Convention provide that, with respect to the application of the respective Conventions by one of the Contracting Parties, any term not otherwise defined shall, unless the context otherwise requires, and subject to Article 25 (Mutual Agreement Procedure), have the meaning which it has under the laws of that Contracting Party relating to the taxes which are the subject of the Convention. Since neither Article II(3) of the Old Convention nor Article 3(2) of the New Convention elaborate on what income tax expenses are allowed as deductions, *the context of those Articles* does not otherwise require, and there has been no mutual agreement under Article 25(3), reference is made to US internal law in accordance with Article II(3) of the Old Convention and Article 3(2) of the New Convention to determine what tax expenses are allowed as deductions.”

This paragraph in Rev. Rul. 80-243 assumes that the only relevant context for the purposes of Article 3(2) is the context of Article 3 itself. This assumption is erroneous. It is not the purpose of *Article 3* to elaborate on matters more properly dealt with in other Articles of the treaty. Article 3 could hardly elaborate upon the issue in Rev. Rul. 80-243 – what income tax expenses are allowed as deductions – so *its* context cannot require that domestic law not be applied. This issue is more properly dealt with under business profits Articles, such as Article 7(3) of the New Convention or Article III(3) of the Old Convention – see Chapter 10.06.

The fact that “the context” for the purposes of Article 3 must (at the least) comprise the whole of a tax treaty (Convention) was accepted in the last paragraph of US: Rev. Rul. 73-419 (Article 12). This clearly refers to a tax treaty as a whole, and not simply Article 3, in holding that an item of income which is undefined in a tax treaty is to

receive the definition applicable under domestic law since (*italics added*) "... the context of *the Convention* does not require otherwise."

7.06 Debates on the meaning of "the context" in Article 3 of the OECD Models

There has been much debate on the meaning of the words "the context" and "requires" in Article 3 of the 1977 OECD Model, notably as regards Article 3(2) – despite Richards' comment (1960, 179): "The problem is essentially a practical one, however, and the analysis must not be allowed to become a thesis on fiscal theory."

For example, Avery Jones *et al.* have queried (1984, 90-95) whether the definition of the words "the context" in Article 31(2) of the Vienna Convention may govern (i.e., in reality, restrict) the meaning of these words in Article 3 of the 1977 OECD Model.

If the OECD Article 3 words "the context" have an "Article 31(2) Vienna Convention" meaning then, so this argument goes, regard can only be had to a tax treaty's *text* in determining whether Article 3(1) tax treaty definitions, or Article 3(2) domestic definitions, are to apply. This is because Article 31(2) of the Vienna Convention defines "the context" to include only the actual treaty text and comparable contemporaneous agreements or instruments. On this basis, these treaty or domestic definitions will almost invariably apply – unless the text (and *only* the text) *requires* them not to apply.

In a separate but related (second) argument, Avery Jones *et al.* have argued (1984, 96-101) that only where the meaning of treaty terms is left "ambiguous or obscure", or this "leads to a result which is manifestly absurd or unreasonable", may recourse be had to supplementary means of interpretation under Article 32 of the Vienna Convention to determine the real meaning of tax treaty terms. Under this second argument, supplementary means of interpretation must be ignored when it contradicts the ordinary meaning of tax treaty terms. As Chapters 4.03 and 21.01 explain, this second argument conflicts with the Vienna Convention interpretative approach. This approach involves giving weight to, and not ignoring, supplementary means of interpretation – especially when they are at their most useful, notably when they show that apparent clarity does not accord with "informed" clarity.

Avery Jones *et al.* correctly concluded (1984, 104) that the first argument (on the meaning of "context") "would make no sense" because: "The use of the word "context" in the limited sense of the Vienna context would have the effect of overriding or ousting those additional tools of treaty interpretation which the Vienna Convention itself indicates are to be used. Context therefore should mean anything that can normally be taken into account or to which one may have recourse in interpreting the treaty."

The definition of "context" is the most important aspect of tax treaty interpretation – so it is important to note that there were always at least five additional reasons why this first argument was always unconvincing; following the publication of the 1992 OECD Model, there is now a sixth. These reasons are as follows.

Firstly, many tax treaties do not contain Articles comparable to Article 3 of the 1977

OECD Model. Accordingly, their terms can only be interpreted in their (general) tax treaty context. There is no evidence that tax treaties which do not contain provisions comparable to Article 3 of the 1977 OECD Model should be interpreted any differently from those that do. Yet, if the latter are not interpreted in their general tax treaty context, identical terms will be interpreted differently. There is no evidence that tax treaty negotiators ever intended this to be the case. Indeed, consistency demands that a single uniform interpretative approach should be applied to all tax treaties – whether or not they contain provisions comparable to Article 3 of the 1977 OECD Model. Accordingly, all tax treaty terms should be interpreted in their tax treaty context.

Secondly, there is nothing to indicate that the words “the context” in Article 3(2) of the 1977 OECD Model are meant to have a narrow “Article 31(2) Vienna Convention” meaning. These words originated in tax treaties decades before the 1980 Vienna Convention emerged (see Chapter 10.01). As Avery Jones *et al.* have researched (1984, 93, Footnote 16) a late-nineteenth century UK provenance can be safely attributed. There is no evidence that, in the many decades before the Vienna Convention was first signed on May 23 1969, negotiators ever focused in detail on the tax treaty words “the context”. At that time, these words could only have had a non-technical general meaning. To search for any “Vienna Convention” meanings in pre-1980 tax treaties or Models is to search for something that simply could not have existed at the time. There is no evidence that the entry into force of the Vienna Convention has changed this conclusion as regards post-1980 tax treaties or Models.

Thirdly, because the words “the context” are themselves undefined in the 1977 OECD Model, Article 3(2) of this Model itself requires these words to be given the meaning they have under the domestic laws of the State applying the treaty (unless the context otherwise requires!). Any domestic meaning will inevitably be general – and unrelated to a narrow “Article 31(2) Vienna Convention” definition.

Fourthly, the only basis for arguing that broad domestic definitions of “the context” should not apply under Article 3(2) is that “the context” requires a narrow “Article 31(2) the Vienna Convention” definition to apply. There is no evidence to this effect; indeed, all the evidence is to the contrary. The words “the context” in Article 3 of the 1977 OECD Model must mean a tax treaty’s general context – because the argument to the contrary, which focuses so minutely on whether this word must receive its Vienna Convention meaning, leads to a result which is at variance with the Vienna Convention itself. The words “the context” in Article 3 should *themselves* be interpreted according to the Vienna Convention – Article 31(1) of which requires them to be given their ordinary meaning. The ordinary meaning of “the context” in which a tax treaty term appears is, unarguably, that of a tax treaty. Thus, the 1984 US Technical Explanation to the 1980 Canada tax treaty construes “context” as referring to “the purpose and background of the provision in which the term appears”. Similarly, Prebble commented (1993, 476): “Context is a general factor that underlies the whole exercise of interpretation.” As Lord Chief Justice Eichelbaum commented in New Zealand: June 14 1990 JFP *Energy* (Article 15; 11 NZTC 6,286): “The context in which the

expression appears is in a broad sense the avoidance of double taxation. In a more particular sense, it is the achievement of that object by nominating one or other of the contracting States as having primacy in the matter of taxation ...” Tax treaty terms must therefore be interpreted in their overall tax treaty context.

The fifth reason why the words “the context” in Article 3 of the 1977 OECD Model mean a tax treaty term’s general tax treaty context is that this is consistent with Article 3’s actual wording – see Chapters 7.12 to 7.14.

The sixth reason why it is now even clearer that the words “the context” in Article 3 of the 1977 OECD Model mean a tax treaty’s general tax treaty context is the (new) definition of “the context” in the second sentence of Para. 12 of the Commentary on Article 3 of the 1992 OECD Model.

This Para. 12 runs in part (*italics added*): “The context is constituted in particular by the intention [*sic*] of the Contracting States when signing the Convention as well as the meaning given to the term in question in the legislation of the other Contracting State (an implicit reference to the principle of reciprocity on which the Convention is based).”

Para. 12’s definition of “context” is so far removed from an “Article 31(2) Vienna Convention” meaning that it is, arguably, even at odds with the general approach to tax treaty interpretation in Article 31(1) of the Vienna Convention. Be this as it may, Para. 12’s confirmation that “the context” includes the meaning given to a term by the *other* Contracting State emphasizes that tax treaty terms must be interpreted in their bilateral tax treaty context, consistent with the common intention of both treaty partner States – see Chapter 5.

7.07 Debates on the meaning of “requires” in Article 3 of the OECD Models

Because the words “the context” occur twice in the same Article 3 of the 1977 and 1992 OECD Models, they should be given the same meaning in each case.

Similarly, because the word “requires” occurs twice in the same Article 3 of the 1977 and 1992 OECD Models, it should also be given the same meaning in each case.

Accordingly, neither treaty (Article 3(1)) nor domestic (Article 3(2)) definitions are to apply where “the context” otherwise requires. In each case, the tax treaty context may govern the meaning of tax treaty terms. The meaning of tax treaty terms (international tax language in an international tax treaty context) must, therefore, be ascertained *before* these treaty (Article 3(1)) or domestic (Article 3(2)) definitions can be applied. The reason for this is simple: Article 3(1) treaty definitions may be inappropriate (see Chapter 7.12), and Article 3(2) domestic definitions are often inappropriate (see Chapter 7.14 and Chapter 8).

To repeat: before treaty or domestic definitions can be applied, the contextual meaning of tax treaty terms – international tax language – must first be ascertained.

Although the above comments strike me as self-evident, this area has been the subject of intense debate – which is now summarised.

7.08 Contextual and comparable approaches to Article 3 of the OECD Models

As regards the first Article 3(2) (Article II(3) of the 1945 UK/US tax treaty) Koch commented (1947, 55): “(a) In the first instance the construction has to comply with the requirements of the context even if such construction should differ from the interpretation of the term under the national rules of the country concerned. The maintenance of uniformity in the interpretation of an international rule is of first importance. (b) If the context does not require otherwise, any term shall have such meaning as it has under the national laws relating to the taxes which are the subject of the Convention.”

Similarly, after accepting that references to domestic law were often essential, van Houtte commented (1968, 42): “The convention must, however, be interpreted in the first instance by itself ...”

In relation to Article 3(2), Avery Jones *et al.* commented (1984, 105): “A number of writers state that internal law should only be used as a last resort”; Footnote 67 cites Tixier (1979, 414) and Korn/Debatin (*Doppelbesteuerung* 1. Tiel, 126).

Tixier, Gest and Kerogues commented (1980 Para. 417, in translation): “417. Renvoi to internal law is thus subsidiary in two respects. It is first of all subsidiary to context, and it is then subsidiary to treaty definitions.”

Debatin and Walter commented (1968, A 5.1.2, italics not added): “The interpretation of a double taxation treaty must therefore, in so far as is possible, be derived from the *treaty itself*. In so far as the treaty contains definitions of a specific concept this is already indicated directly. If there are none the applicable treaty provision must be interpreted from its own *meaning and context*. Only if this does not yield an answer can one reach to domestic law as an *interpretation aid*.”

Other commentators agree with Debatin’s view that a reference to domestic law should only be made as a matter of last resort. Thus Teichner, cited by van Raad (1978, 9), commented (1967, 147): “The sequence that must be followed in the interpretation of a term in a double tax agreement is, therefore, as follows: at first one should ask whether, and how, the term has been defined in the treaty. If it has not been defined in the treaty, one should then attempt to clarify it from its context within the framework of the treaty. If nothing is obtained from this method (which is normally the case) then the only remaining possibility is to interpret it under national law.”

Avery Jones *et al.* commented (1984, 106): “This argument is taken one stage further by a Dutch writer, Peeters, himself a treaty negotiator, who stated: “Only if no context exists (which will be only in exceptional cases) could interpretation according to national law prevail. Consequently, interpretation according to national law is virtually excluded.” [*Edited Footnote 69*: Peeters 1954, 138.] Apart from the idea of an item not having a context being difficult to imagine, it does not seem very likely that the draftsmen of the OECD Model would have included Article 3(2) if that was all its purpose.”

This criticism of Peeters may result from difficulties in translating his original Dutch text. What I think Peeters meant was not “if no context exists” but “if no contextual

meaning exists". In other words, what I think Peeters meant was: only in the exceptional case of there being no contextual meaning can undefined terms be interpreted according to national law.

7.09 Other approaches to Article 3 of the OECD Models

In contrast to the above, others have either ignored the relevance of context, or have expressed a preference for treaty or domestic (rather than contextual) meanings, or have expressed no preference for contextual meanings.

As an example of context being ignored, Doernberg has noted (1993, 109 notably footnote 33) that the US international training materials (International Issues for International Examiners (Vol. 1) at 9-2.5) completely ignore context and simply run: "Paragraph 2 of Article 3 provides that any term not defined in the treaty is to be defined as having the meaning it has in the country to whose tax the treaty applies."

This lack of focus on context, and the excessive application of (possibly changing US) domestic law, is evident in, for example, US: LR 78-44-008 (Article 7 and see Chapter 10.05).

As an example of a preference for treaty and domestic meanings, van Raad has rejected Teichner's sequence (see Chapter 7.08) and has suggested (1978, 9 and 10) an alternative sequence: "An open and unprejudiced reading of Article 3(2) of the OECD Model Convention appears rather to show that: a) first, one has to look for a definition in the treaty itself; b) if that fails, the term will have the meaning which it has in the national laws of the relevant State; only if this meaning conflicts with what follows from the context of the treaty provisions, does the interpretation on the basis of the context take precedence."

Similarly, Vogel has argued (1986, 73 and 1991, 139-140) that no priority should be given to a contextual meaning – because Article 3(2) uses the verb "requires" and does not include words such as "unless the context yields no other, or absolutely no other, interpretation".

Vogel commented (1991, 140): "It is thus expressly stated that not every apparently convincing interpretation from the context should give rise to a divergence from the rule of Article 3(2) but only those based on relatively strong arguments."

Approving of Vogel's approach, Avery Jones *et al.* commented (1984, 108): "*Requires* is a word of some force, as is *exige* in the French version, and *erfordert* in the German unofficial translation published by the Ministry of Finance. The context must, therefore, be reasonably strong for the internal law meaning to be ousted."

Vogel concluded (1991, 140): "The history and development of the provision both confirm that an interpretation contrary to the meaning a term has under domestic law must constitute an exception." As indicated in Chapter 10.01, the history and development of Article 3(2) do not support this conclusion.

Shannon has taken a somewhat similar line. He commented (1989, 460): "... a systemic preference for interpretation from the context does not exist. Logically, whether the context "otherwise requires" can be determined only if the meaning of the

term under domestic law already has been established. Thus, it appears equally plausible to suggest that interpretation based on domestic law actually has priority.”

However, Vogel and Prokisch have also accepted (1993, 82) that “the context” should be interpreted “in its broad sense”.

7.10 Another contextual approach to Article 3 of the OECD Models

My views on the above debate can be summarised succinctly.

Firstly, Article 3 does not lay down any sequence pursuant to which any meanings must be ascertained. Accordingly, debates as to whether the contextual meaning of an undefined tax treaty term should be ascertained before a domestic meaning, or whether Article 3(2)’s reference to domestic law means that domestic meanings should be ascertained first, serve no useful purpose. Article 3(1) requires treaty *and* contextual definitions and/or meanings to be ascertained – and Article 3(2) requires domestic *and* contextual definitions and/or meanings to be ascertained. It is irrelevant in which order these requirements are satisfied. The (often overlooked) point is that the contextual meaning of tax treaty terms must be ascertained before treaty or domestic definitions and/or meanings can be *applied*. The key issue, therefore, is: if a contextual meaning conflicts with an Article 3(1) treaty definition or an Article 3(2) domestic definition, which definitions and/or meanings should prevail?

Despite the wide diversity of the views expressed above, it is arguable that there is a large measure of agreement on what Article 3(2) *should* say. It should say that contextual meanings should normally prevail. However, van Raad (1978), Vogel (1991) and Avery Jones *et al.* (1984) take the position that this is not what Article 3(2) *does* say – because it uses the word “requires” (which they regard as so strong a term that treaty or domestic meanings should normally prevail over contextual meanings).

My view (and that of others) is that “the context” – which embodies the parties’ common intentions – should be given the importance it deserves. Thus, when a conflict arises between a contextual meaning and an Article 3(1) treaty definition or an Article 3(2) domestic definition, the contextual meaning should prevail – because this is what the context requires. As Katz has commented (1993, 650): “The intent of the parties *is* the context. There is no question of whether contextual interpretation is preferred to domestic. The very concept of context implies that it must be.”

My view is supported by Sweden: *December 23 1987 Supreme Court* (Article 13). In a statement which was approved by the Supreme Court, the National Tax Board held: “Domestic tax rules shall be applied except when the context otherwise requires. In the opinion of the Board, the meaning of this restriction can be summarised as follows: Where a term in a treaty, as used in any particular provision, does not give a clear indication of its meaning, it is necessary to try and to establish intention of the contracting parties. In so doing, guidance should be sought from the terminology of the treaty as a whole, its structure and systematic approach, the function of the article in question, its introduction and historical context as well as other relevant circumstances. Only if such analysis does not lead to any result should recourse be had to the meaning

of the term under the domestic law of the State applying the treaty.”

My view is consistent with the 1992 ALI Report. It takes the view (as regards Article 3(2) – 41, italics added) that, although the “unless the context otherwise requires” proviso (which it correctly elevates to the status of a principle) is “stated as an exception to the rule that reference is to be made to the domestic law of the state applying the treaty, it is nonetheless best understood as a second, distinct “level” of interpretative authority the application or non-application of which must be settled *before* reference is made to domestic law.”

My view is also consistent with my understanding of the Vienna Convention’s interpretative approach – see Chapter 4. One can only be certain that the apparent meaning of tax treaty terms accords with their real meaning once one has interpreted them, as international tax language, in their tax treaty context. Thus, Article 3(1) treaty definitions are not conclusive where the *tax treaty context* otherwise requires. Similarly, Article 3(2) domestic definitions are not conclusive where the *tax treaty context* otherwise requires. This approach is that most likely to result in the meaning of tax treaty terms being determined autonomously, in their international tax treaty context – see Chapter 1. It is also consistent with the proposition, implicitly accepted by the OECD Models, that references to domestic law should, as far as possible, be avoided – see Chapter 8.14.

7.11 Does Article 3(2) of the OECD Models apply to undefined concepts?

Because Article 3(2) of the OECD Model only permits a reference to domestic law in the case of an undefined “term”, it has been debated (see Avery Jones *et al.* 1986, 85) whether reference can be made to domestic law to determine the meaning of a concept. Vogel considers (1991, 136) such a reference to be impermissible.

A term will often express a concept (see US: April 11 1983 *Burghardt Estate* (Article 3 and Chapter 10.11)) – so this debate can become academic.

Be this as it may, the application of domestic concepts in a tax treaty context is particularly likely to lead to differing interpretations – hindering the development of a uniform approach. Accordingly, my view that the “international tax treaty” meaning of a term must be ascertained before domestic law can be applied is of even greater relevance to tax treaty concepts. This is because tax treaty concepts will often have even more autonomous tax treaty meanings than tax treaty terms (which may have a domestic provenance).

Therefore, to the extent to which it is permissible (under a broad interpretation of the word “term” in Article 3(2) or otherwise) to refer to domestic law to define a tax treaty concept, it is particularly important for the contextual “international tax treaty” meaning of such concepts to be ascertained before such domestic concepts are applied.

This view echoes that of the State Secretary of the Netherlands in *Netherlands: June 26 1968 HR* (Article 23), who commented (see Timmermans – 1993, 459): “... Article 3(2) should not be regarded as meaning that, if a certain concept is not explicitly defined in the treaty, a similar concept from domestic law should be derived from it

without question in every case. It should be remembered that an international treaty contracted between parties with differing systems of law cannot easily avail itself of concepts which are derived directly from one of these systems, or from both. In the interpretation of such a treaty, therefore, careful consideration should be given as to whether the meaning of a certain concept used in it, which is not explicitly defined, can be deduced from the context before consulting a similar concept in domestic law.”

The danger of applying (changing) domestic law to define a tax treaty concept is vividly illustrated by US: Rev. Rul. 83-144 (Article 24) – see Chapter 8.14.

7.12 Treaty definitions; Article 3(1) of the OECD Models

Why does Article 3(1) of the OECD Models provide that its *treaty* definitions are not to apply where the context otherwise requires? The need for the meaning of terms in their tax treaty context to overrule treaty definitions is easily explicable.

Tax treaty definitions have only emerged in the last few decades – and are often still immature. As Michel commented (1951, 19): “... international tax law is a discipline of recent formation; it cannot draw upon similar precedents like civil and commercial law; this law in formation necessarily suffers from an insufficiency of vocabulary, from poorly assimilated and awkward expressions, and from definitions which are still equivocal.” For example, the definition of “an enterprise of a Contracting State” in Article 3(1)(c) of the 1977 OECD Model should not apply in relation to Article 24(6) of this Model. This is because Article 24(6) seeks to preclude “an enterprise of a Contracting State” owned by residents of the treaty partner State from being subjected to more burdensome taxation in that State than “other similar” enterprises – yet Article 3(1)(c) defines “an enterprise of a Contracting State” as one carried on by residents of the *same* State. Were this Article 3(1)(c) definition to apply to Article 24(6), Article 24(6) would only apply to an enterprise of a Contracting State carried on by residents of that same State yet owned by residents of the treaty partner State. Article 24(6) is clearly meant to apply to an enterprise of a Contracting State carried on by residents of the treaty partner State.

Furthermore, tax treaty definitions have never been subjected to the exhaustive scrutiny which domestic tax legislation usually attracts. They typically follow a model which neither signatory State may have analysed in-depth. They often represent a compromise between two States – not precisely defined (or over-refined) terms with a long and complex domestic provenance.

The difficulties that courts can experience when they ignore the fact that tax treaty definitions should not be applied where “the context otherwise requires” are illustrated by UK: June 23 1972 *Strathalmond* and March 1 1982 *Exxon* (both Article 4).

Strathalmond and *Exxon* both involved Articles II and XV of the 1945 US tax treaty.

In common with Article 3(1) of the 1977 OECD Model, Article II(1) provided that its treaty definitions were not to apply where the context otherwise requires.

Strathalmond held that when Article XV referred to a UK “resident”, this term *had* to be defined according to the definition of the term “resident of the UK” in Article

II(1)(g) – see Chapter 12.09. V.-C. Pennyquick did not focus on the fact that the treaty’s context might require a different definition to apply. He conferred unintended (and unreciprocal – see Chapter 12) tax benefits on a US citizen resident in the UK.

In *Exxon* the court again failed to focus on the tax treaty context of a tax treaty term. Goulding J. declined to give Article XV’s terms their plain and ordinary meaning. He preferred to read Article XV in a way (not, as he admitted, the most natural way) that, he thought, enabled it to have some practical effect – see Chapter 6.04. He commented (56 T.C. 253): “Accordingly, although it seems to me that upon the plain meaning of the words used, the expression “resident of the other Contracting Party” in that sentence does import the residence definitions [in Article II(1)] (which V.C. Pennyquick thought almost too clear for words in relation to the comparable phrase in the first sentence) I must nevertheless give it a different construction, so that it does not fail of effect. In coming to this conclusion I bear in mind that the words of the Convention are not those of a regular Parliamentary draftsman but a text agreed on by negotiation between the two contracting governments. ... I am thus constrained to do violence to the language of the Convention ...”

Goulding J. justified his doing violence to the treaty’s language by commenting that his conclusion was in accordance with “the broad policy behind it” and its “intended purpose”. This is the closest a UK court has come to adopting a purposive approach to tax treaty interpretation – and this unwelcome proximity was quite unnecessary. Goulding J. had no need to adopt such a purposive approach, to “do violence to the language of the Convention”, and to make his unfortunate decision that similar words meant different things in two succeeding sentences of the same Article. He could simply have held that the tax treaty context clearly required that the treaty definitions in Article II(1) not apply.

7.13 *The context may require some tax treaty or domestic definitions to apply*

Article 3(1) of the 1977 and 1992 OECD Models does not define all the terms used therein. Some terms are defined in other Articles, notably when these terms relate specifically to those Articles. For example, “permanent establishment” is specifically defined in Article 5, “royalties” are defined in Article 12(2), and “professional services” are defined in Article 14(2). These OECD Models do not provide that these specific definitions are not to apply where “the context otherwise requires” – precisely because the tax treaty context *does* require them to apply. For the same reason, OECD Commentary does not indicate that its many definitions should not apply where “the context otherwise requires”.

Other definitions in these OECD Models, such as residence, nationality and immovable property, *have* to follow definitions in domestic law – see Chapters 8.02 to 8.06. These Models do not provide that these domestic definitions are not to apply where “the context otherwise requires” – again, precisely because the tax treaty context *does* require them to apply.

7.14 Domestic definitions; Article 3(2) of the OECD Models

Why does Article 3(2) of the 1977 and 1992 OECD Models provide that *one* State's *domestic tax* definitions of undefined tax treaty terms are not to apply where the context otherwise requires? The need for the meaning of terms in their tax treaty context to overrule *one* State's *domestic tax* definitions is even more easily explicable than the need for them to overrule treaty definitions.

Firstly, *one* State's definitions should not determine the meaning of terms in a bilateral treaty – see Chapter 5.

Secondly, references to *domestic* laws (and definitions therein) should generally be discouraged – see Chapter 8.14.

Thirdly, some *tax* law in a State may be quite inappropriate in an international tax treaty context. In partial recognition of this, the only (tax) laws which can be taken into account under Article 3(2) are those “concerning the taxes to which the Convention applies.”

Fourthly, even *tax* laws “concerning the taxes to which the Convention applies” may be inappropriate to define a “State” and its territory – see Oliver (1990, 307).

Excessive focus on domestic tax definitions, without regard to whether they are appropriate, may inhibit tax treaty terms being analysed in their tax treaty context – see Chapter 8. This may explain why Article 3(2)'s requirement that the *tax* law of the State applying the treaty is to govern undefined tax treaty terms conflicts with Para. 12 of the Commentary on Article 3(2) of the 1992 OECD Model.

Para. 12 effectively provides that the tax laws (as defined) of the State applying the treaty is not to govern where (*italics added*): “... the meaning given to the term ... in *the legislation* of the other Contracting State” otherwise requires.

The application of Para. 12 leads to the curious result that the *tax* laws (as defined) of the State applying the treaty is not to govern undefined tax treaty terms where the *general* legislation of the *other* Contracting State otherwise requires. This reference to the other State's general legislation seems to acknowledge that a term's ordinary legal meaning, rather than its technical *tax* meaning in *one* State, may be more likely to represent its mutually agreed treaty meaning.

Similarly, as the examples in Chapter 8.17 onwards illustrate, ordinary domestic definitions may often be more appropriate in a tax treaty context than domestic tax definitions – which can be quite extraordinary and unsuitable in a tax treaty context.

In all cases, therefore, the tax treaty context of tax treaty terms is crucial.

Chapter 8 The ordinary meaning of tax treaty terms and domestic laws

8.01 *A tax treaty's context may require domestic law to govern some of its definitions*

To search for a universal meaning for every tax treaty term is to search for an illusion; each tax treaty term must receive its own interpretation – for three reasons. Firstly, although the majority of tax treaty terms are derived from standard Models, “tax treaties themselves are by no means uniform” (to use Patrick’s words – 1978, 613). Secondly, even uniform tax treaties will have different backgrounds and contexts (see Chapters 22 to 25). Thirdly, (inevitably differing) domestic laws must sometimes be used to define the same tax treaty terms. For example, the 1977 and 1992 OECD Models deliberately define some terms by reference to domestic laws. They do not provide that these domestic definitions are not to apply where “the context otherwise requires” – precisely because this tax treaty context *does* require them to apply. Thus, these Models require a national, a resident and immovable property to be defined by reference to domestic laws – which may differ.

8.02 *Domestic law must define nationality*

It is axiomatic that nationality must be defined by reference to the law of the State(s) conferring it – because the status of nationality can only depend upon this law.

Article 24(2) of the 1977 OECD Model ran (italics added): “The terms “nationals” means: *a) all individuals possessing the nationality of a Contracting State; b) all legal persons, partnerships and associations deriving their status as such from the laws in force in a Contracting State.*” When Articles 4(2)(c) and 4(2)(d) of the 1977 OECD Model referred to a “national”, without defining this term, the Article 24(2)(a) definition was the only one which could apply.

Article 24(2) now appears as Article 3(1)(f) of the 1992 OECD Model which runs (italics added): “the term “national” means: *(i) any individual possessing the nationality of a Contracting State; (ii) any legal person, partnership or association deriving its status as such from the laws in force in a Contracting State.*”

Because this definition now appears in Article 3 of the 1992 OECD Model, it does not apply where “the context otherwise requires”. This proviso does not mean that nationality can be defined other than by reference to the law of the State(s) conferring it. It only means that the context may preclude domestic definitions of nationality from applying if they are substantially modified – see Chapters 9 and 10.

The application of a State’s (changing – see Chapter 10) domestic law to define its nationals is illustrated by UK: February 5 1975 *Nothman* and February 5 1975 *Oppenheimer* (both Article 18).

In *Oppenheimer* the House of Lords unequivocally held that the issue of whether *Oppenheimer* was a German “national” under the 1954 and 1964 Germany tax treaties had to be determined by German law. Nevertheless, on the grounds of public policy, their Lordships would not recognise a 1941 Nazi decree which stripped him of his German citizenship because he was Jewish. On this basis it was held that he remained a

German national. As a restated Case, however, it became clear that a 1949 German Law (which had entered into force before the date of the tax treaty) offered those who had been stripped of their German nationality the chance to apply for it back. Their Lordships held that this 1949 Law cleansed German law of its previous Nazi contamination – so that German law could be applied once again. Because Oppenheimer had not sought German nationality, he was *not* a German national and was not exempt from UK tax on German pensions.

Lord Salmon commented (50 T.C. 220): “It was not the odious Nazi decree of 1941 but his own failure to apply in time under the benevolent ... Law enacted in 1949 which deprived him of exemption from UK income tax ...”

8.03 *Stateless persons*

Under Article 24(3) of the 1977 OECD Model, which has become Article 24(2) of the 1992 OECD Model, a stateless person resident in a State is entitled to benefit from non-discrimination Articles in that State’s tax treaties. Article 24 does not define a stateless person – but Para. 20 of the 1977 (and Para. 18 of the 1992) OECD Commentary provides that this term “can only be that laid down in” Article 1(1) of the September 28 1954 New York Convention on Stateless Persons. This Article 1(1) defines a stateless person as (*italics added*): “a person who is not considered as a national by any State under the operation of *its law*” i.e. its domestic law.

8.04 *Domestic law must define a political subdivision or local authority of a State*

Just as the domestic law of a State must define a national, so the domestic law of a State must determine whether an entity is one of its political subdivisions, or a local authority (for the purposes of Articles 17(2) and 19 of the OECD Models).

US: December 23 1981 *Constantine* (Article 19) dismissed a claim by a resident of Greece that a pension paid to him by the Bank of Greece was a Government pension. Tietjens J. applied Greek law and stated simply (43 TCM 159): “We find that the Bank is a private legal entity and is not a subsidiary of the Greek government. See Decision No. 1058/1954, (E.E.N.21), p.1185 (Supreme Administrative Court); Decision No. 2308/1952, *Themis* (64), p.134 (Supreme Administrative Court).”

8.05 *Domestic law must define a resident*

The 1977 and 1992 OECD Models necessarily require a resident of a Contracting State to be defined by reference to that State’s laws. Thus, Article 4(1) of these Models starts: “For the purposes of this Convention, the term “resident of a Contracting State” means any person who, *under the laws of that State*, is liable to tax therein by reason of his domicile, residence, place of management or any criterion of a similar nature.”

In common with Article 24 of both these Models, Article 4(1) does not contain Article 3’s proviso “unless the context otherwise requires” – because this proviso would not be appropriate. Article 4(1) *necessarily* defines a resident by reference to the laws of the State claiming residence – so that tax treaties may avoid double taxation

being suffered by *any* person whom a State might ever deem to be a resident.

To fulfil their tie-breaker functions, Articles 4(2) and 4(3) must also apply to *any* person whom a State characterises as one of its residents. Accordingly, Articles 4(2) and 4(3) attribute a sole treaty residence to *any* person characterised as a resident by both States – whether or not such characterisations are reasonable. Indeed, the more aberrant such characterisations, the greater the need for Articles 4(2) and 4(3) to overrule them.

8.06 Domestic law should define immovable property

There is a long-established tradition of treating immovable property law as “*lex specialis*”. Thus, Para. 8 of the Commentary of Article 3(2) of the 1963 OECD Draft ran in part: “The rule of interpretation in paragraph 2 of Article 6 on the taxation of income from immovable property, which has to be regarded as “*lex specialis*”, is in no way affected by the present general rule of interpretation.”

Accordingly, and helpfully, Article 6(2) of the 1977 and 1992 OECD Models defines immovable property by reference to the general (not tax) law of the State where it is situated. Article 6(2) starts: “The term “immovable property” shall have the meaning which it has *under the law of the Contracting State* in which the property in question is situated.”

This mandatory reference to *one* State’s law seeks to avoid conflicting meanings of “immovable property”. However, it may not succeed in avoiding conflicting views as to what is immovable property, and as to whether income or capital gains are derived from immovable property.

Germany: *May 19 1982 BFH* (Article 13) illustrates the domestic law of the State of situs being applied to define immovable property. A German resident bought an option to buy real estate in Spain. 18 days later he sold this option at a gain. He argued that his gain was exempt (with progression) from German tax – because the option was immovable property as defined by Article 6(2) of the 1966 Spain tax treaty.

Article 6(2) ran in part: “(2) The term “immovable property” shall be defined in accordance with the law of the Contracting State in which the property in question is situated. The term shall in any case include ... rights to which the provisions of general law respecting landed property apply ...”

The BFH held that Article 6(2) required Spanish “law” to determine whether the option was immovable property. In this context “law” should be construed generally, and should not be limited to tax law. However, neither Spanish tax law nor Spanish civil law contained any provisions deeming an option over real estate to be real estate itself. Although the April 6 1967 Spanish law on inheritances treats such an option as if it is immovable property, it does not treat it as *being* immovable property. An option could be considered immovable property, pursuant to Article 14 of the December 14 1947 Decree governing the Spanish Immovable Property Register, if it was registered in this Register – but this had not been done. Accordingly, the gain on the option was not a gain on immovable property (taxable only in Spain) but a gain on “other” (Article

13(3)) property (taxable in Germany).

In another example of the domestic law of the State of situs being used to define immovable property, Sweden: *May 10 1989 Supreme Court* (Article 4) holds that a share in a Swedish housing association owning certain leasehold rights in Swedish real property is immovable property for the purposes of the 1983 Canada tax treaty.

8.07 Domestic law may also determine Article 3(1) tax treaty definitions

Article 3(1) of the 1977 and 1992 OECD Models impliedly accepts that domestic law may flesh out other skeletal tax treaty definitions – *unless the context otherwise requires*.

For example, Article 3(1)(a)'s definition of a "person" includes terms which are themselves not defined – namely "an individual" and "any other body of persons". These terms can only be interpreted by reference to a (domestic) system of law.

Similarly, when the 1977 and 1992 OECD Models provide that a defined term "includes" certain items, it implies that yet more terms may also be included. Were the included items meant to be exhaustive, these Models would provide that the meaning of the defined term was *restricted to* these (included) items. For example, instead of beginning "the term "person" *includes* an individual", Article 3(1)(a) would begin: "the term "person" *shall be restricted to* an individual ..."

Para. 2 of the Commentary on Article 3 of the 1977 and 1992 OECD Models makes this point specifically. Para. 2 begins: "The definition of the term "person" given in sub-paragraph *a*) is not exhaustive and should be read as indicating that the term "person" is used in a very wide sense ..."

When treaty definitions are not exhaustive, domestic law may provide guidance as to what other terms they should include – unless the context otherwise requires.

Article 3(1) of the 1977 and 1992 OECD Models refers explicitly to domestic law in defining a "company". Article 3(1) runs: "1. For the purposes of this Convention, unless the context otherwise requires: ... *b*) the term "company" means any body corporate or any entity which is treated as a body corporate for tax purposes; ..."

Para. 3 of the Commentary on Article 3 of the 1977 and 1992 OECD Models starts (*italics added*): "3. The term "company" means in the first place any body corporate. In addition, the term covers any other taxable unit which is treated as a body corporate according to the *tax laws* of the Contracting State in which it is *organised*."

Para. 3 seemingly provides that the corporate laws of the State where an entity is organised will, in the first place, determine whether it is a body corporate/company. Furthermore, this State's tax laws may also deem a non-corporate entity to be a company if it is treated as a body corporate for tax purposes.

The infelicity of this definition is such that one can only be thankful that it does not apply where "the context otherwise requires". It would seem, for example, that a non-corporate entity which is *not* taxed as a body corporate in its State of incorporation, but which *is* taxed as a body corporate in its different State of residence, would not qualify as a company. The context may therefore require different definitions to apply –

especially when Articles 5(7), 10 and 16 of the 1977 and 1992 OECD Models are involved.

Under Article 5(7), the fact that one *company* controls another shall not, of itself, constitute a permanent establishment. Although Article 5(7) is inappropriately restricted to companies, Article 5's preceding provisions (possibly combined with a liberal interpretation of Article 3(1)(b)) should preclude the existence of a permanent establishment when non-corporate (associated) entities are involved.

Article 10(1) only applies to: "Dividends paid by a *company*" – so dividends can only be paid by an entity which is a "company".

Article 16 provides that director's fees can only be derived from "a *company* which is a *resident* of the other Contracting State".

The infelicity of Article 3(1)(b)'s reference to domestic law stems largely from the 1977 and 1992 OECD Models' failure to resolve the issues of who, or what, should qualify as a "person" and/or a "resident".

8.08 *Domestic (tax) law may also help to define other (undefined) tax treaty terms*

There are several reasons why domestic law can help to define other terms which are undefined in a tax treaty.

Firstly, domestic laws may often be able to provide definitions – and thus provide some measure of certainty. This has always been the advantage of a provision such as Article 3(2) of the 1977 and 1992 OECD Models – see Chapter 10.13.

Secondly, it is natural for a domestic court to refer to its own domestic law. This is the law most readily available to it, that with which it is the most familiar, and that which it alone has the authority to interpret.

Thirdly, a tax treaty will typically have been drafted against the background (see Chapter 24.01) of each treaty partner State's domestic tax laws – with which it has to interact. References to such domestic tax laws may therefore be unavoidable.

It is particularly natural for courts to interpret a tax treaty term in the light of domestic tax legislation when this treaty specifically permits this legislation to apply.

For example, the Netherlands taxes a gain made on a sale of shares in a Netherlands company in which the vendor has a substantial interest. The Netherlands has renegotiated several tax treaties to enable it to tax such gains. The 1951 Switzerland tax treaty was amended to this effect in 1966 – but the terms used in the amendment are not the same as those used in the Netherlands legislation imposing this tax.

Even though this treaty does not contain a provision comparable to Article 3(2), Netherlands: *August 18 1989 Hertogenbosch GH* (upheld by *November 4 1992 HR* – Article 13) nevertheless interpreted the terms in the amendment by reference to the terms in the Netherlands domestic legislation imposing this tax. It held that because the amendment seeks to preserve the Netherlands' right to tax, it should not be interpreted more restrictively than the Netherlands domestic legislation imposing this tax.

Fourthly, domestic tax laws are the sources of several tax treaty terms and concepts – and definitions therein may provide guidance as to their meaning. In a clear example of

tax treaty material borrowing concepts from domestic tax law, the 1979 OECD *Transfer Pricing* Report (see Chapter 23.09) recommends the adoption (worldwide – see Chapter 26.16) of the same four methods of ascertaining the arm's length sales prices of goods that have long been adopted in regulations on s.482 of the US Internal Revenue Code. These are the comparable uncontrolled price method, the resale price method, the cost-plus method and any other acceptable method.

However, a definition in domestic tax law should not be applied when it conflicts with the plain, ordinary, meaning of a tax treaty term.

For example, Germany: *December 13 1989 BFH* (Article 13) involved a resident of Germany who gave each of his two children (also residents of Germany) 4.5% of the shares in GmbH (a German company) in which he held one third of the shares. The children then emigrated from Germany to Canada. On July 9 1974 both children sold their shares, each making a capital gain of DM272,000.

The German tax authorities argued that these gains were taxable under German domestic law (s.17(91) EStG) as gains made on a sale of a substantial interest.

Article IX(3) of the 1956 Canada tax treaty permitted Germany to tax "profits from the sale of shares in a company of the Federal Republic in which the vendor had a substantial interest."

December 10 1986 Baden-Wurtemberg FG held that Article IX(3)'s explicit reference to sales of shares in a company in which the vendor has a substantial interest should be construed as an implicit reference to Germany's domestic law taxing gains made on sales of such shares, namely s.17(1) EStG. Under s.17(1) EStG, a donee/vendor (who may never have had a substantial interest himself) is taxable on gains made on shares he sells which had formed part of a substantial interest owned by the donor in the previous five years. Accordingly, the FG held that Article IX(3) permitted Germany to tax this gain.

On appeal, *December 13 1989 BFH* dismissed the assessment. It held that Article IX(3) required the *vendor* to have a substantial interest (the definition of which was to be determined, under s.17(1) EStG, as a shareholding of 25% or more) – and the (vendor) children had never had such an interest.

8.09 Domestic law may be referred to even in the absence of an Article 3(2)

Because domestic laws interact so closely with tax treaties, they have often been referred to even when a tax treaty does not contain an Article comparable to Article 3(2) of the 1977 OECD Model (which requires undefined tax treaty terms to receive domestic definitions, unless the context otherwise requires). Unsurprisingly, this has often occurred when domestic and undefined tax treaty terms are identical.

For example, Canada: February 13 1985 *Taran Furs* (Article 7) had to decide whether the term "interest" in the 1955 Denmark and 1959 Finland tax treaties included interest for late payment of goods. These treaties did not define "interest" and did not contain provisions comparable to Article 3(2) of the 1977 OECD Model. Both parties accepted, nevertheless, that the "ordinary meaning" of interest should apply –

and, to support their different arguments, they both invoked Canadian domestic law and the same OECD materials (see Chapter 26.01).

Tremblay J. held (85 DTC 202): "... I am inclined to say that the word "interest" in its ordinary meaning includes not only borrower-lender interest but also interest originating from late payment for property acquired for the purpose of gaining and producing income. ...

As there is no definition of the word "interest", neither in the *Income Tax Act*, nor in the Canada-Finland Agreement, it seems that the ordinary meaning given above, should be accepted. However, as the *Lebern* decision has not been reversed by a higher court, I am thereby bound by the said decision."

Lebern, a 1976 Canadian non-treaty decision, had held that the interest element in a late payment was part of the cost of goods, and was *not* interest.

The correctness of Tremblay J.'s holding that a Canadian non-treaty decision on the meaning of "interest" should determine its meaning in a tax treaty context is questionable – especially since he also felt that this meaning differed from the ordinary meaning. His holding may, however, be explicable by the fact that it enabled him to grant treaty relief.

Unsurprisingly (see Chapter 10.04 onwards), several US rulings apply US domestic laws to interpret and characterise undefined terms – even though the 1942 Canada tax treaty in issue did not contain any provisions comparable to Article 3(2).

US: Rev. Rul. 56-446 (Article 13) involved the issue of whether a lump sum distribution from a US pension fund payable on the death of an employee was a pension. Article VIA of the 1942 Canada tax treaty exempted a US pension paid to a resident of Canada from US tax – but it did not define a pension, or contain an Article comparable to Article 3(2).

Rev. Rul. 56-446 notes that under US domestic law such a lump sum distribution is a capital gain – to the extent that it exceeds the employee's contributions. It implies that this excess should, similarly, not fall within the treaty definition of a pension – and should be considered a capital gain. US domestic law should govern – even in the absence of an express provision to this effect in the treaty. However, Rev. Rul. 56-446 then notes that the treaty also exempts a Canadian resident from tax on such a capital gain. It therefore holds: "... it is unnecessary to consider whether the type of distribution in the instant case constitutes a capital gain, or a pension or life annuity under the tax convention, as under any of these classifications the distribution would be exempt from taxation in the US."

Avery Jones *et al.* commented (1984, 23 footnote 35) that it appears from Rev. Rul. 56-446 (and from US Treasury Regulations – see the discussion of LR 85-24-004 (Article 13) below) that the US tax authorities interpret the 1942 Canada tax treaty as if it contains an Article 3(2). That the US tax authorities do interpret this treaty in this way is made clear by Rev. Rul. 58-247 (Article 13) – which modified Rev. Rul. 56-446.

Rul. 58-247 holds that when US domestic law characterises a lump sum payment as a

capital gain, this characterisation will be determinative. Accordingly, the only treaty Article exempting such payment from tax is the capital gains Article.

The rationale of Rev. Rul. 58-247 was followed 27 years later in LR 85-24-004 (Article 13) – which also holds that US domestic law may govern the definition of a term even in the absence of a provision comparable to Article 3(2).

LR 85-24-004 runs in part: “The term “capital assets” contained in Article VIII of the [1942 Canada] Convention is not defined in the Convention. Section 519.110 of the regulations promulgated pursuant to the Convention (T.D. 5206, C.B. 1943, 526), refers to section 117 of the Internal Revenue Code of 1979 for those types of assets which constitute capital assets. Section 117(a)(1)(B) of the Internal Revenue Code of 1989 contained an exclusion from the definition of capital assets under the 1939 Code substantially similar to the exclusion contained in section 1221(2) of the 1954 Code.

Since both Taxpayer and the [IRS examining agent] are in agreement that the shopping centre sold by Taxpayer in 1978 is property described in section 1221(2) of the Code, it accordingly does not qualify as a capital asset.”

Interestingly, LR 85-24-004 then also holds that the IRS may revise its perception of which provision of US domestic law should govern – which, in itself, is an example of one reason why references to domestic law should be avoided (see Chapter 8.10). LR 85-24-004 continues: “However, this office is of the opinion that focusing on whether or not there has been a sale or exchange of a capital asset as defined in section 1221 of the Code too narrowly limits the scope of Article VIII of the Convention.

It has been represented that the shopping centre is “property used in the trade or business” as defined in section 1231(b) of the Code. Since, as has been represented for the year 1978, the Taxpayer’s recognized gains on sales or exchanges of property used in the Taxpayer’s trade or business (including the gain from the shopping centre) exceed the recognized losses from such sale or exchanges, pursuant to 1231(a) such gains and losses are considered as gains and losses from sales or exchanges of capital assets held for more than one year.

Therefore, pursuant to section 1231(a) of the Code, the gain on the sale of the shopping centre is considered to be a gain from the sale or exchange of a capital asset held for more than one year. This capital asset treatment under section 1231(a) of the Code is sufficient to qualify the shopping centre as a capital asset under Article VIII of the Convention.

This interpretation of the term “capital asset” is consistent with the holding and rationale of Rev. Rul. 58-247 ...”.

The fact that domestic law can be referred to even in the absence of a provision comparable to Article 3(2) of the 1977 and 1992 OECD Models raises the questions: does Article 3(2) serve any useful purpose – and, even if it does, does it nevertheless create more problems than it solves? These questions are discussed in Chapter 10.13.

8.10 References to domestic laws should, as far as possible, be avoided

Although a tax treaty may have to be interpreted by reference to domestic law in

some situations, references to domestic law should be avoided to the greatest extent possible. As the 1992 ALI Report comments (61): “The Institute has taken the position that reference to domestic law ordinarily should be made only when other interpretative techniques do not support a treaty interpretation. This approach will further the international development of common treaty interpretations and increase the likelihood of similar results in similar cases.”

As indicated above, the 1977 OECD Model only *requires* domestic definitions to apply when this is axiomatic (nationality, etc.), necessary (resident), helpful (immovable property) or, for the time being, unavoidable (dividends – see Chapter 8.11).

Furthermore, when defined terms are to be interpreted by reference to domestic law under Article 3(1), these domestic definitions are not to apply where the context otherwise requires. Similarly, when undefined terms are to be interpreted by reference to domestic law under Article 3(2), these domestic definitions are not to apply where the context otherwise requires – see Chapter 7.

The proposition that references to domestic law should be discouraged derives support from the Commentary on Article 10 and (to a greater extent) Article 11 of the 1977 and 1992 OECD Models. Para. 23 of the Commentary on Article 10 of both Models makes it clear that references to domestic law should, as far as possible, be avoided. Para. 19 of the Commentary on Article 11 of the 1977 OECD Model (which is identical to Para. 21 of the Commentary on Article 11 of the 1992 OECD Model) *completely precludes* the application of domestic law – to ensure that tax treaties remain unaffected by future changes in any country’s domestic laws.

8.11 *The OECD Models reluctantly accept that domestic laws must define dividends*

Article 10(3) of the 1977 and 1992 OECD Models defines dividends by reference to the domestic laws of the distributing company’s State of residence – and not its (possibly different) State of incorporation.

Article 10(3) runs in part: “The term “dividends” ... means income from shares ... as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares *by the laws of the State of which the company making the distribution is a resident.*”

This reference to domestic law was made reluctantly – and only because such a reference has, so far, proved unavoidable.

Para. 23 of the Commentary on Article 10 of the 1977 OECD Model made it clear that thorough attempts to eliminate references to domestic law were frustrated by dissimilarities in domestic laws. Para. 23 ran in part (italics added): “In the course of the revision of the 1963 Draft Convention, *a thorough study has been undertaken to find a solution which does not refer to domestic laws.* This study has led to the conclusion that, in view of the still remaining dissimilarities between Member countries in the field of company law and taxation law, *it does not yet appear to be possible* to work out a definition of the concept of dividends that would be independent

of domestic laws.”

Para. 23 of the Commentary on Article 10 of the 1992 OECD Model is identical to its predecessor – save that, instead of the italicised words “it does not yet appear to be possible”, it resignedly substitutes the words “it did not appear possible”.

8.12 *The OECD Models preclude domestic law from defining interest*

Para. 19 of the Commentary on Article 11 of the 1977 OECD Model (and the identical Para. 21 of the Commentary on Article 11 of the 1992 OECD Model) *preclude* domestic law being referred to in a search for the meaning of “interest” – which should therefore be defined *exclusively* by reference to Article 11(3).

Their second sentences run (italics added): “It has seemed preferable not to include a subsidiary reference to domestic laws in the text; this is justified by the following considerations:

a) the definition covers practically all kinds of income which are regarded as interest in the various domestic laws;

b) the formula employed offers greater security from the legal point of view and ensures that *conventions would be unaffected by future changes in any country’s domestic laws*;

c) *in the Model Convention references to domestic laws should as far as possible be avoided.*”

Baker notes (1991, 186 footnote 10 and 1994, 251 footnote 11) that this preclusion “suggests that the decision in ... [Canada: September 28 1982 *Melford*; Article 7] (which referred to the domestic law definition) is wrongly decided.” Quite the contrary. The 1956 Germany tax treaty at issue in *Melford* did not contain a definition of interest – but it did contain a provision comparable to Article 3(2) of the 1977 and 1992 OECD Models. *Melford* correctly decided (for the wrong reasons – see Chapter 10.08) that the *current* Canadian domestic definition of interest should *not* apply in a tax treaty context. *Melford*’s case would, indeed, have been strengthened had it referred to this (subsequent) OECD Commentary – see Chapter 26.15.

8.13 *Why don’t the OECD Models preclude domestic law from defining royalties?*

Given the reluctance of the 1977 and 1992 OECD Models to define dividends by reference to domestic law, and their preclusion of the use of domestic law to define interest, it is regrettable that the Commentary on Article 12 does not also discourage domestic law from being referred to in defining royalties. This may simply be an oversight – but the following explanations are equally likely.

Firstly, Article 12(2)’s definition of a “royalty”, which includes “payments of any kind ... for information”, is much wider than domestic definitions – which typically require royalties to be paid by reference to the use of rights. Accordingly, the OECD Committee on Fiscal Affairs may have hoped that no references would ever be made to domestic law in any event. Any such hopes will have been dashed by US: October 16 1984 *Boulez* (Article 12 – see Chapters 8.19 and 26.14).

Secondly, the Committee may have felt, in 1977, that the autonomous tax treaty meaning of the term “royalty” had not yet evolved sufficiently. That this was indeed the case is evidenced by the fact that, in Para. 23(a) of the 1985 OECD *Equipment Leasing* Report (see Chapter 23.10), this Committee recommended that income from leasing equipment be excluded from the definition of royalties. This recommendation was adopted in the 1992 OECD Model – see Chapter 9.03.

Rapid evolutions in computers and communications are likely to lead to further evolutions in the meaning of royalties in the future – see Chapter 9.03; this may partly explain why the Commentary on Article 12 of the 1992 OECD Model still does not discourage domestic law from being referred to in defining royalties.

8.14 Four reasons why references to domestic laws should be discouraged

There are four reasons why references to domestic law should be discouraged in a tax treaty context.

Firstly, one State’s domestic law is, by definition, unilateral. Unilateral domestic law will typically take no account of a treaty partner State’s views. No unilateral definitions should govern the meaning of bilateral tax treaty terms – which should be interpreted in accordance with the common understanding of *both* States (see Chapter 5). This is the main reason why provisions comparable to Article 3(2) of the 1977 OECD Model should only be applied if the tax treaty context does not otherwise require.

Secondly, any references to domestic laws are likely to lead to differing interpretations – because different States’ domestic laws will, typically, differ. Only in the unlikely event of both States’ laws being identical will a tax treaty term be interpreted identically in each State.

The greater the extent to which domestic meanings govern the meaning of tax treaty terms, the more a tax treaty’s operation will be affected by the myriad differences in States’ domestic laws. These differences will lead to a tax treaty being interpreted (differently) by each treaty partner State according to *its* (different, and possibly inappropriate) domestic law. This may result in double taxation and/or no taxation at all – despite, in both cases, competent authority agreements (see Chapter 27).

The third reason why references to domestic law should, as far as possible, be avoided is that domestic laws can change – instantly, imperceptibly and with bewildering frequency. Indeed, one State’s perceptions of which of its domestic (tax) laws should govern may even change – see US: LR 85-24-004 (Article 13 and Chapter 8.09).

The application of one State’s *changed* domestic definitions or laws may be wholly incompatible with the principle that treaty meanings must reflect the common understanding of both treaty partner States. One State’s changed domestic definition should only apply when this was explicitly or implicitly contemplated by, and accepted in advance by, the treaty partner State – see Chapters 9 and 10. As the 1992 ALI Report notes (42) when discussing Article 3(2): “In this regard, the interpretation of income tax treaties might appear to have a uniquely unilateral element. As discussed ...

in many circumstances a bilateral meaning will be preferred.”

As Chapter 7.11 indicates, it is particularly perilous to attempt to define tax treaty concepts by reference to domestic tax concepts – which can change at any time for reasons wholly unrelated to tax treaties. This peril may have been overlooked in US: Rev. Rul. 83-144 (Article 24) – which highlights the issue of whether, and to what extent, a unilateral change in one State’s laws should change the meaning of a concept in an existing bilateral tax treaty which may have been concluded years earlier.

Rev. Rul. 83-144 holds: “Although they are not synonymous, the concept of taxing profits attributable to a permanent establishment in the US in the context of an income tax convention is analogues [*sic*] to the concept of taxing income effectively connected with the conduct of a trade or business embodied in section 864(c). Rev. Rul. 81-78 [Article 7] ...” Accordingly, Rev. Rul. 83-144 holds: “Based upon the relevant domestic case law and the analogy to section 864 of the Code, the activities of the US office of the foreign pension trust, consisting of investing in stocks and securities for its own account, do not constitute engaging in a trade or business for purposes of Article 5 of the Convention. Therefore, the US office of this foreign pension trust does not constitute a permanent establishment as defined in Article 5 of the Convention.”

Rev. Rul. 83-144 does not seem to foresee that the US domestic definition of “conduct of trade or business” may change. If such a change occurred, would the IRS argue that all US tax treaty definitions had changed simultaneously – in unison?

The fourth reason why references to domestic law should be discouraged is that some domestic laws may not interface satisfactorily with tax treaties. For example, there may be more than one domestic definition of a tax treaty term – or, indeed, no domestic definition of a tax treaty term. More importantly, the context and background of domestic definitions will often be wholly unrelated to a tax treaty context.

The 1977 OECD Model’s lack of success in defining a company by reference to one State’s domestic law has been noted in Chapter 8.07.

Comparable difficulties have arisen when a company’s residence has been defined (necessarily – see above) by reference to a State’s domestic law. UK: March 1 1982 *Exxon* (Article 4) and February 9 1990 *Commerzbank* (Article 7) both amply illustrate these difficulties – see Chapters 6.04 and 6.05.

Canada: June 18 1990 *Alberta Gas* (Article 4) is further example of domestic laws on residence giving an unusual result. In *Alberta Gas* a combination of tax treaty provisions, and a change in Canadian domestic law which referred to these provisions, resulted in the residence of a (US) Delaware corporation being deemed to have switched, all of a sudden, from Canada to the US.

Because of their domestic (i.e. non-treaty) provenance, definitions in domestic tax law may be quite unsuitable in a tax treaty context. Distinctions may have had to be drawn in domestic legislation (or jurisprudence) which have absolutely no relevance in an international tax treaty context. Accordingly, to the extent possible, the “international tax language” in tax treaties should receive its autonomous meaning – see Chapter 1.

8.15 *Some examples of inappropriate domestic tax definitions*

The dangers of ignoring the international tax treaty context of tax treaty terms, and of blindly applying one State's domestic tax definitions, are illustrated by decisions in Australia, Canada, France and the US. These decisions, which are deliberately chosen because they all involve provisions comparable to Article 3(2) of the 1977 and 1992 OECD Models, illustrate that ordinary tax treaty terms may have domestic tax meanings in one State which are totally inappropriate in an international tax treaty context – and which should not, therefore, be applied. By deflecting attention away from the tax treaty context in which tax treaty terms appear, Article 3(2)'s reference to one State's domestic tax laws can, therefore, often be more misleading than helpful – see Chapter 10.13.

8.16 *Inappropriate domestic tax definitions; Australia: August 22 1990 Thiel*

Thiel (Article 7) involved the issue of whether, under Article 3(1)(c) of the 1980 Switzerland tax treaty (which is identical to Article 3(1)(c) of the 1977 and 1992 OECD Models), an enterprise was carried on by a resident of Switzerland.

Instead of trying to ascertain the meaning of these words *in their tax treaty context*, the lower courts prematurely invoked Article 3(2) of the tax treaty (which is identical to Article 3(2) of the 1977 and 1992 OECD Models) – and applied it far too literally. They focused on Australian domestic tax law – and adopted a distinction therein which was of no relevance in an international tax treaty context.

Franklyn J. (in the Western Australian Supreme Court) and Sheppard L.J. and Lee L.J. (in the Full Federal Court) sought to distinguish the words “carried *on*” from the words “carried *out*”. The bulk of their lengthy judgments focus, inappropriately and unnecessarily, on Australian decisions distinguishing between the carrying *on* – and the carrying *out* – of a business. There is no evidence that such a distinction was ever meant to be drawn in a tax treaty context.

Article 3(1)(c) of the 1977 and 1992 OECD Models (and the 1980 Switzerland tax treaty) defines an “enterprise of a Contracting State” to be “an enterprise carried on by a resident of a Contracting State”. The key point this definition seeks to make is that an enterprise must be undertaken by a *resident* of a Contracting State – and not that an enterprise must be carried *on* (and not merely carried *out*) by such a resident. There is no evidence that the words “carried on” are meant to distinguish activities which are carried *on* from activities which are carried *out*; they are merely used to denote by whom the enterprise must be undertaken. Indeed, the word “undertaken” could be substituted for the words “carried on” with no loss of effect or meaning.

The reason why Article 3(1)(c) of the 1977 and 1992 OECD Models uses the words “carried on” is that Article 7 (Business Profits) and Article 5 (Permanent Establishment) use similar words.

Article 7 begins: “1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other

Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.”

Article 7(1) does not seek to differentiate between a business carried *on* through a permanent establishment and a business carried *out* through a permanent establishment. Article 7(1) focuses on whether the business undertaking gives rise to a permanent establishment – in which event the State where this permanent establishment is located may tax the business profits attributable to it. To achieve its purpose, Article 7(1) could also have used the word “undertakes” instead of the words “carries on” with no loss of effect or meaning.

The above comments are supported by Para. 4 of the Commentary on Article 3(1)(c) of the 1977 and 1992 OECD Models. Para. 4’s heading is: *The Term “Enterprise”*; it then begins (italics added): “4. The question whether *an activity* is performed within the framework of an enterprise or is deemed to constitute in itself an enterprise has always been interpreted according to the provisions of the domestic laws of the Contracting States.”

Para. 4 make it clear that an enterprise can simply be the performance of an activity – or the activity itself. There is no requirement that the activity be carried *on*, as opposed to carried *out*; it merely has to be performed. An activity only has to exist for an enterprise to exist. The words “carried on” thus relate primarily to Article 7 (which provides that a business has to be carried on through a permanent establishment in a State before this State can tax its business income) and not to Article 3(1)(c) (which provides that an “enterprise” of a State is one carried on by a resident of that State).

In line (sometimes word for word) with the above comments (which originally appeared in *The International Tax Treaties Service* – only) the Full High Court in *Thiel* unanimously overruled both lower courts. The Full High Court correctly analysed the treaty words in their tax treaty context – and sought to ascertain their *tax treaty* meaning without misleading itself by referring to domestic law.

8.17 Inappropriate domestic tax definitions; Canada: June 5 1992 Hale (Article 15)

Hale should also have adopted the approach of Australia’s Full High Court in *Thiel*. *Hale* holds that a UK resident’s income from stock acquisition rights under a Canadian company’s executive share option plan was not “remuneration” and was therefore taxable in Canada. Because the 1978 UK tax treaty did not define “remuneration”, the Trial Division interpreted this term, again pursuant to a provision identical to Article 3(2) of the 1977 and 1992 OECD Models, by reference to Canadian domestic law.

Basing himself upon a Canadian non-treaty decision, Rouleau J. held (90 DTC 6487): “It must therefore be concluded that the words “salaries, wages and other remuneration” unavoidably correspond to a sum of money received in return for the provision of services.

I would further add that the wording of Article 15 of the Convention between Canada and the UK does not conflict with such an interpretation. It should be noted that the

legislature has used the word “income” in Article 14 with respect to professional services, and the word “remuneration” for dependent personal services. ...

We also note that the legislature used the word “income” in respect of the situation of artistes and athletes, covered by Article 16 of the Convention: ...”

In the same vein, Rouleau J. held (90 DTC 6488) that the income “... is not “remuneration” within the meaning of Article 15(1) of the Convention ... but a benefit received by virtue of employment as stated in s. 7(1)(b) of the *Income Tax Act*.”

Rouleau J.’s holding is questionable. Articles 14 and 16 of the 1978 UK treaty, in common with their 1977 and 1992 OECD Model analogues (Articles 14 and 17 respectively), use the word “income”. They do so because “income” accurately describes the type of income earned by the (self-employed) persons covered by these Articles.

However, the word “remuneration” (and not “income”) is used in the *text* (only) of Article 15 of the treaty and its OECD Model analogue (Article 15).

Article 15’s text provides that it covers “salaries, wages and other remuneration”. However, there is strong evidence that Article 15 uses the term “remuneration” simply because it describes sums earned by employees more accurately than “income” – and that Article 15 is meant to cover *all income* from employment (other than pensions).

Thus, Para. 1 of the Commentary on Article 15 of the 1977 and 1992 OECD Models starts (*italics added*): “Paragraph 1 establishes the general rule as to the taxation of *income* from employment (other than pensions), namely, that such *income* is taxable in the State where the employment is actually exercised.”

The OECD Commentary would not have used the word “income” if the word “remuneration” in the text of Article 15 was meant to restrict the type of employment income/remuneration covered by Article 15. The use of the word “remuneration” in the text of Article 15 simply reflects the fact that Article 15 only applies to *employees*; the words “income from employment” could be substituted for the word “remuneration” without changing Article 15’s intended meaning or effect.

Unfortunately, however, neither Rouleau J. nor the Court of Appeal considered any OECD Commentary – such was their focus on Canadian law.

If Article 15 does cover all “income from employment”, a further issue is whether income from stock appreciation rights is income from employment. It is inconceivable that Hale’s employer (the multinational Alcan) could have granted him these rights in any context other than that of a remuneration package. Indeed, Rouleau J. himself admitted (90 DTC 6488 – see above) that these rights were a “benefit received by virtue of employment”. His adoption of a Canadian domestic distinction (between an income-generating “benefit received by virtue of employment” – and other income from employment) is unconvincing in a tax treaty context.

In the Federal Court of Appeal, Hale reiterated his argument that his income was covered by Article 15. However (surprisingly, if only in view of the above comments which had originally appeared in *The International Tax Treaties Service* – only) Hale argued that because the terms “salaries, wages and other similar remuneration” in

Article 15 of the treaty were not defined therein, they should be defined according to domestic tax law, pursuant to Article 3(2) of the treaty and s.3 of the Income Tax Conventions Interpretation Act. In a somewhat contradictory vein, however, he also argued that Canadian domestic tax law, notably s.7(4) of the Income Tax Act, should *not* apply – because it was incompatible with Article 15.

The Court of Appeal dismissed Hale's arguments. s.7(4) of the Income Tax Act provided that an employment shall be deemed to continue to exist; in other words, it deemed Hale's employment to be exercised in Canada in 1984. s.7(4) and Article 15(1) – which also required Hale's employment to be exercised in Canada – were not incompatible; rather, they were complementary.

This Court of Appeal decision is almost as unsatisfactory as that of the Trial Division. A possible explanation of both these Canadian decisions is that, under UK law, Hale may not have been liable to UK tax on the income in question. In most (other) circumstances, however, both decisions would probably cause double taxation – because, in conformity with the ordinary meaning of the words of Article 15, a residence State would normally tax income from stock appreciation rights derived by one of its residents who did not exercise any employment in the source State in the year in question. Pursuant to Article 3(2) of the tax treaty (and the OECD Model), and s.3 of the Income Tax Conventions Interpretation Act, the tax treaty context therefore required that Canada's domestic definitions not apply.

Perhaps the most interesting aspect of *Hale* is the Crown's secondary argument that even if Article 15 of the treaty did cover Hale's remuneration, s.7 of the Act (which deemed him to exercise an employment in Canada in 1984 – even though he did not in fact exercise any employment in Canada in that year) should override it. This argument was probably inspired by Canada: January 25 1983 *Gadsden* (Article 13) – see Chapter 24.03.

8.18 Several French decisions show that references to domestic law should be avoided

French commentators have long argued that French domestic characterisations should be applied with caution in a tax treaty context – see, for example, Derouin (1979, 402).

In France: *November 7 1986 CE/2* (Article 15) the Commissaire correctly decided not to rely on a definition in domestic law. He noted that in *November 26 1975 CE* (Article 7) and *July 3 1985 CE* (Article 12) the Conseil d'Etat had interpreted tax treaty words by reference to domestic law pursuant to treaty Articles comparable to Article 3(2) of the 1977 OECD Model. However, he should also have noted that the Conseil d'Etat's reliance on domestic law led to unusual results in both cases.

November 26 1975 CE (criticised by Derouin 1976, 908, and see Chapter 28.08) held that a Canadian company building and selling apartments in France was not taxable on its profits – because they were industrial or commercial profits (under French domestic law and hence under the tax treaty) and not income from immovable property.

July 3 1985 CE held that royalties paid by RCA to the heiress of a conductor in respect of his recordings were not "royalties" – but other income.

However, the Commissaire did note that *November 25 1968 CE* (Article 21) had held that tax treaty words should be interpreted as they stood – without reference to domestic law. In line with this approach, he correctly concluded (as the French tax authorities argued) that the fact that a VRP (travelling salesman) was an employee for the purposes of the French Labour Code should not determine whether a VRP was an employee for the purposes of the 1959 Germany tax treaty. On other grounds, however, he (and the Conseil d'Etat) concluded that a VRP was an employee and not self-employed.

8.19 *An inappropriate focus on domestic law; US: October 16 1984 Boulez (Article 12)*

Pursuant to a contract signed in 1969, CBS Records paid the conductor Boulez royalties (and other sums – see Chapter 26.14) in consideration of his agreeing to conduct several recording sessions and to give it all rights in the resulting recordings. At issue was whether the royalties paid to Boulez in 1975, which were linked to sales of these recordings, were (undefined) “compensation for labor or personal services” under Article X of the 1954 Germany tax treaty – or “royalties”.

Article VIII(3)(a) of this treaty defined “royalties” to include (*italics added*): “... *any royalties, rentals or other amounts paid as consideration for the use of, or the right to use, copyrights, artistic or scientific works (including motion picture films, or films or tapes for radio or television broadcasting), patents, designs, plans, secret processes or formulae, trademarks, or other like property or rights, or for industrial, commercial or scientific equipment, or for knowledge, experience or skill (know-how) ...*”

Körner J. assumed that, if these payments to Boulez were not “royalties”, they would be “compensation for labor or personal services”. He therefore began his opinion by holding (83 T.C. 590) that the issue of whether the payments to Boulez were “royalties” was dependent upon two questions: (1) did Boulez intend to license or convey “a property interest in the recordings” to CBS Records and (2) did Boulez “have a property interest in the recordings which he was capable of licensing or selling”.

Körner J. held that the first question was one of fact – and the second, one of law. As regards the second question (of law) Körner J. held (83 T.C. 591): “The treaty is not explicit, and we have found no cases or other authorities which would give us an interpretation of the treaty on this point. We are therefore remitted to US law for the purpose of determining this question. Treaty, *supra* at Article II(2).”

Article II(2) began: “In the application of the provisions of this Convention by one of the contracting States any term not otherwise defined shall, unless the context otherwise requires, have the meaning which the term has under its own applicable laws ...”

In common with Article 3(2) of the 1977 and 1992 OECD Models, Article II(2) thus permitted Körner J. to refer to US domestic law – but only to define any undefined term. However, “royalties” *were* defined in Article VIII(3)(a) – so Körner’s immediate reference to US domestic law to ascertain whether the royalties were indeed “royalties”

was not permissible under Article II(2). Not only was it not permissible – it was an error. One recalls Boulay de la Meurthe’s phrase on hearing of the execution of the Duc d’Enghien (Sainte Beuve 1870, 52): “C’est pire qu’un crime, c’est une faute” (“It is worse than a crime, it is an error”). It was an error because it led to Körner J. to focus on the irrelevant question of whether Boulez had a “property interest” (words which did not appear in Article VIII, but which had a US domestic provenance) in the recordings.

Körner J. began his analysis of the second question of law by holding (83 T.C. 593): “Before a person can derive income from royalties, it is fundamental that he must have an ownership interest in the property whose licensing or sale give rise to the income.” This holding was based upon US domestic law, and Körner J. proceeded to cite US authorities on this point.

Körner J. then held (83 T.C. 593 italics added, Footnote 4 omitted): “In its definition of royalties, the treaty embodies the same fundamental concept of ownership. Thus, in Article VIII(3)(a), “royalties” are defined to mean “amounts paid as consideration for the use of, or *the right to use*, copyrights, artistic or scientific works ... *or other like property or rights*,” and Article VIII(3)(b) also states that the term “royalties” shall include gains derived from the alienation of *any right or property* giving rise to such royalties.” (Emphasis supplied.)

It is clear, then, that the existence of a property right in the payee is fundamental for the purpose of determining whether royalty income exists, and this is equally true under our domestic law as well as under the treaty.

Did the petitioner have any property rights *in the recordings* which he made for CBS Records, which he could either license or sell and which would give rise to royalty income here? We think not.”

Körner J. then addressed Boulez’s argument that he could acquire copyrightable interests in the CBS recordings after the enactment of the Sound Recording Amendment of 1971. He felt that Boulez’s contractual relationship with CBS Records went on as before because (83 T.C. 595): “... the parties saw no need to modify the contract because they understood that even after the Sound Recording Act of 1971, petitioner still had no licensable or transferable property rights in the recordings which he made for CBS Records and we think this was correct.”

Because Boulez had no copyrightable property interest in the recordings which he created for CBS Records even after 1971, and because his contract with CBS Records specifically provided that all such rights were to reside in CBS Records, Körner J. held (83 T.C. 596) that Boulez had no “property interest in the recordings, either before 1971 or thereafter, which he could license or sell to CBS Records so as to produce royalty income within the meaning of the treaty. This conclusion, in turn, reinforces our belief, which we have found as a fact, that the contract between petitioner and CBS Records was one for the performance of personal services.”

Judge Körner’s regrettable focus on US domestic law and on whether Boulez had a “property interest in the recordings” was misplaced – for five reasons.

Firstly, it is arguable that Article VIII (in common with Article 12 of the 1977 and 1992 OECD Models) focuses primarily on payments for “use ... or the right to use” – rather than on payments for “property or rights”. (This argument is discussed further in Chapter 26.14). Körner J. should have focused more closely on whether the payments to Boulez took the form of royalties – which they clearly did. As Körner J. commented (83 T.C. 591): “... the contract consistently refers to the compensation which petitioner is entitled to receive as “royalties”, and such proceeds are tied directly to the proceeds which CBS Records was to receive from sales of recordings which petitioner was to make. Both these factors suggest that the parties had a royalty arrangement ...”

Secondly, a payment can be a “royalty” under Article VIII even if it is not paid in respect of property. For example, it can be paid in respect of a right. Körner J. should have focused on the fact that CBS Records had to make these (royalty) payments to Boulez – because he had exchanged his quasi-copyrights (or, to use the words of Article VIII(3)(a), “other like rights”) in the recordings for “rights” under his contract with CBS Records. Para. 7a of this contract recognised Boulez’s rights when it provided (83 T.C. 586, italics added): “For your services rendered hereunder and *for the rights granted to us herein* we will pay you the following royalties.” The fact that Boulez had no “property interest” or right *in the recordings* was therefore irrelevant – precisely because, under Para. 7a, he had exchanged his quasi-copyrights in the recordings for his rights under the contract. No alteration of this contract was necessary after the Sound Recording Amendment of 1971 recognised Boulez’s copyrights – because Boulez had already exchanged what had hitherto been quasi-copyrights for contractual rights.

The fact that Boulez had contractual rights becomes evident if one appreciates that Boulez could have sold his right to receive future royalties. Could Körner J. have regarded these sales proceeds as also being “compensation for labor or personal services”? He would probably have had to hold that any consideration for Boulez’s cancellation of his contractual rights to future royalties was (also) a “royalty” – because, as envisaged by Article VIII(3)(b), it represented “... gains from the alienation of any right or property giving rise to such royalties”. Such a holding obviously predicates Boulez having a “right” – because only in this event can Article VIII(3)(b) apply.

The third reason why Körner J.’s focus on domestic law (and on whether a property interest existed) was an error, was that it probably led him to overlook the fact that a payment can be a “royalty” under Article VIII even if it is not paid in respect of “property or rights”.

The (definitional) Article VIII(3)(a) did not require a “right” to exist before a payment could be a “royalty”. A “royalty” could comprise (italics added): “... any ... amounts paid ... for ... *experience or skill* (know-how)”. The (non-definitional) Article VIII(3)(b) only mentioned a “right” because a capital gain will typically involve the alienation of a right.

Furthermore, it is arguable that if the royalties CBS Records paid Boulez were not in

respect of his contractual rights, they were royalties paid for his *experience* and *skill* in the conducting field. As Körner J. held (83 T.C. 595, italics added): “Here, the petitioner, a musical conductor of world-wide reputation, was employed to make recordings for CBS Records, and in doing so, was to exercise his peculiar and unique *skills* in accordance with his *experience*, talent and best judgment.”

The fourth reason why Körner J.’s focus on domestic law was an error, was that it led him to come to a decision which (as he was well aware) caused double taxation. Germany (Boulez’s State of residence) had taxed these payments as royalties – and, as Chapter 26.14 describes, competent authority proceedings had failed to resolve these conflicting US and German characterisations.

The fifth reason why Körner J.’s focus on domestic law was an error, was that it led him to ignore 1972 OECD provisional Revised Commentary. Had Körner J. considered this Commentary (which post-dated the 1954 tax treaty in issue but pre-dated the 1975 payments in issue) he could have avoided double taxation – see Chapter 26.14.

8.20 Which State’s law should govern the meaning of undefined tax treaty terms?

Article 3(2) of the 1977 and 1992 OECD Models provides in part (italics added): “As regards the application of the Convention by a Contracting State any term not defined therein shall ... have the meaning which it has under the law of *that* State ...”

The italicised words indicate that a State must apply its *own* domestic law in determining the meaning of a term which is undefined in a tax treaty – unless the context otherwise requires. That this is the generally accepted meaning of Article 3(2) is borne out by four facts.

Firstly, Article 3(2)’s history (see Chapter 10.01) shows that tax authorities originally drafted Article 3(2) so that they could interpret undefined tax treaty terms by reference to their own domestic law. Article 3(2) enables them to retain as much sovereignty as possible. In some cases this retention of sovereignty is explicit.

For example, Article II(2) of the 1954 US/Germany tax treaty, cited in Chapter 8.19 in relation to US: October 16 1984 *Boulez* (Article 12), explicitly provides that the State applying a treaty may define undefined terms by reference to (italics added) “*its own applicable laws*”.

In US: January 16 1963 *Samann* (Article 25 and see Chapter 28.14), Judge Bryan described (313 F.2d 463) Article II(2) of the 1951 Switzerland tax treaty (a provision comparable to Article II(2) of the 1954 US/Germany tax treaty) as: “Conclusive evidence of the signatories’ desire to retain their own scheme of taxation ...”

In UK: December 1 1960 *ICI* (Article 23) Lord Evershed, M.R., took it for granted (31 T.C. 383) that Article II(3) of the 1946 Australia tax treaty (a provision comparable to Article 3(2) of the 1977 and 1992 OECD Models) enabled the UK, the State applying the treaty, to apply its own (preceding year) rules of assessment – which differed from Australia’s (current year) rules.

Similarly, in UK: March 29 1968 *London Produce* (Article 5) all agreed that a determination as to whether a company was a “broker” under the definition in s.373(1)

of the UK's Income Tax Act 1952 would determine whether it was a "broker" within the meaning of the 1947 South Africa tax treaty. Although not apparent from the Court Report, this agreement was doubtless reached because this treaty contained a provision comparable to Article 3(2) of the 1977 and 1992 OECD Models.

Thus, although one can debate the extent to which provisions comparable to Article 3(2) actually do preserve the sovereignty of the State applying a tax treaty (see Chapter 10.13), there can be no doubt that such preservation was originally intended.

Secondly, tax authorities want undefined tax treaty terms to be defined by their own domestic law – because this is the only law with which they are wholly familiar. It is inconceivable that they ever saw Article 3(2) as imposing a requirement to define treaty terms by reference only to the domestic law of a treaty partner State. Such a requirement would be nonsensical – quite apart from being burdensome.

Thirdly, every decision and ruling involving provisions comparable to Article 3(2) interpret them as meaning that the State applying a treaty may apply its own domestic laws. Indeed, even when a tax treaty does not contain a provision comparable to Article 3(2), courts and tax authorities (notably US tax authorities) have often referred to their own domestic law in interpreting treaty terms – see Chapter 8.09.

Fourthly, the second sentence of Para. 12 of the Commentary on Article 3(2) of the 1992 OECD Model, which requires a State to consider (*italics added*): "the meaning given to the term in question in the legislation of the *other* Contracting State", only makes sense if the former State is the State applying the treaty – and the *other* Contracting State is its treaty partner State.

However, Avery Jones *et al.* have suggested (1984, 48) that the meaning which Article 3(2) obviously has – that the State applying a tax treaty may apply *its own* domestic law – is only "a possible meaning", and that in some circumstances Article 3(2) requires a State to apply the domestic law of its treaty partner State.

This suggestion does not seem to have been prompted by any realisation of the need to interpret a term in a bilateral tax treaty in accordance with the common understanding of *both* States (see Chapter 5) or in the light of its bilateral tax treaty context (see Chapter 7.10) or so as to limit references to domestic law (see Chapter 8.14). It was prompted by the realisation that the application of Article 3(2)'s obvious meaning is "almost certain to give the result that there is a difference in interpretation between the two States, leading to the possibility of double taxation or no taxation at all".

To avoid double taxation, and double non-taxation, Avery Jones *et al.* (1984, 50-54), Avery Jones (1993, 608-610) and Déry and Ward (1993, 281-284) suggest an ingenious approach whereby any residence State applying a tax treaty must accept that its treaty partner source State has priority in applying its domestic law.

The textual justification for this approach is based upon Article 3(2)'s opening words, which refer to the "application of the Convention". This approach postulates that the "application" of a tax treaty only occurs when a State forgoes tax that would, in the absence of the tax treaty, be due under its domestic law. Typically, tax is forgone by

virtue of a provision comparable to Article 23 of the OECD 1977 and 1992 Models – which requires a residence State to exempt (or give a credit for source State tax on) income or capital which may, in accordance with the provisions of the Convention, be taxed in the source State.

This approach argues that the words “the application of the Convention” in Article 3(2), when linked to provisions comparable to Article 23, require a residence State to give the source State the primary right to tax. Thus, if the source State decides to tax, the residence State should exempt what is taxed (or give a credit for this tax). However, if the source State decides not to tax items which the tax treaty allows it to tax, the residence State should then have the right to tax these items. The residence State could exercise this right either by a specific taxing provision, or by a general provision (perhaps comparable to France’s Article 165 *bis* CGI) taxing any income which is not taxed by a treaty partner State.

There are six reasons why this approach may not often find favour.

Firstly, this approach involves a loss of sovereignty for the residence State. The fiscal impact of this loss will increase if source States change their domestic laws so as to extend their taxing rights. Some States will find such losses, and any resulting loss of revenue, unacceptable. Two decades ago, Debatin and Walter commented (1968, A 5.1.2): “... it cannot be expected that a contracting State would, solely to avoid interpretation disputes, forego application of its own domestic law and allow foreign law to be controlling.” Even though losses suffered by a State when it is a residence State may be balanced by gains when it is a source State, losses are unlikely to match gains exactly. Accordingly, capital-exporting States (i.e., typically, OECD Member States) will lose more than they gain if they accept that source States’ (changing) definitions should always prevail.

Secondly, as the 1992 ALI Report (under)states (62), “this approach, while producing results which are consistent with the general purposes of the treaty, is difficult to derive from the language utilized in Article 3 paragraph 2.”

There is no suggestion in Article 3(2), or in its 1977 or 1992 OECD Commentary, that a residence State has to accept a source State’s definitions – however desirable this might often be. There is not even any suggestion in Article 23, or in its 1977 or 1992 OECD Commentary, that a residence State has to accept a source State’s definitions – see Chapter 8.22.

Furthermore, this approach depends upon giving a particular meaning to the word “application” – even though there is no indication in the text of Article 3(2) that its general meanings should not apply. The *Shorter Oxford English Dictionary on Historical Principles* gives the following general definitions of “application”: “3. The bringing of anything to bear practically upon another” or “4. The putting of anything to a use or purpose” or “5. The bringing of a general or figurative statement to bear on a particular case.” Vogel and Prokisch point out (1993, 78) that comparable general meanings would also normally apply in Austria, Germany and Scandinavia.

It is difficult to see why a State only applies a tax treaty when it forgoes tax. For

example, a State may apply a tax treaty to determine whether it can tax. Thus, it may apply a tax treaty to characterise income, and it may apply provisions comparable to Articles 5 and 7 of the 1977 and 1992 OECD Models to see whether it can tax business profits. The tax treaty may permit it to tax – or may not permit it to tax; irrespective of which conclusion is reached, the conclusion can only be reached by an application of the treaty. Such applications of a tax treaty can be quite independent of any obligations to relieve double taxation. However, Avery Jones argues that when a State applies a treaty in these ways it is not in fact applying it – it is only reading it. He comments (1993B, 47): “... there is no application of a treaty when a state merely reads the treaty to find out whether it is entitled to tax the income or not.”

Thirdly, even Avery Jones accepts (1993B, 56) that in one case (remuneration for government service covered by Article 19(1)(a) of the OECD 1977 and 1992 Models) the residence State may apply “its own internal law to determine such questions as the meaning of remuneration, whether it is paid for services, and whether it is paid in connection with a business.” Avery Jones comments (1993B, 55): “... it is no part of my case to claim that the residence state does not apply the treaty in these circumstances.” However, he claims that such an application of the treaty, which does not involve Article 23 because (1993B, 56): “... taxation is exclusive [*sic*] to either the source or the residence state ...”, is not an application of treaty as defined by Article 3(2) – precisely because Article 23 is not involved. This approach involves interpreting Article 3(2) as meaning that an application pursuant to its terms can only arise when Article 23 is involved – even though neither Article 3(2) nor any of its Commentaries have ever referred to Article 23.

Avery Jones also claims (1993B, 56) that because taxation under Article 19 is exclusive to either the source or the residence State, “there is no room in this case for any conflict of definitions.” However, such conflicts can arise. For example, under the law of a residence State a sum may be taxable there because it is characterised as paid in connection with a business carried on by the source State. This same sum may be characterised differently by the laws of the source State – which (also) claims that *it* has the exclusive right to tax it.

Fourthly, this approach ignores the (original) intentions of those responsible for drafting the OECD Model and of treaty partner States. It is inconceivable that any persons drafting or adopting provisions comparable to Article 3(2) could ever have intended the word “application” to be interpreted as this approach suggests – if only because this approach was first suggested four decades after Article 3(2) had made its first appearance (see Chapter 10.01). At the time of Article 3(2)’s first appearance, there was even less consensus on whether a source State has a primary right to tax than there is today – when this debate is, in any event, still active (see Vogel, Brands and van Raad 1994). Furthermore, as Chapter 10.01 also illustrates, it is quite clear that States typically intend Article 3(2) to preserve their right to interpret a tax treaty according to their own law – to the extent the context allows.

Fifthly, the only way this approach can succeed in avoiding double taxation in all

cases is if a residence State accepts source State characterisations *in all cases*. But what if a source State characterisation conflicts with a (correct) characterisation by the residence State? Should the residence State nevertheless accept the source State's erroneous characterisation? One would have thought that to ask this question is to answer it – yet, under this suggested approach, this is precisely what a residence State should do. For example, it is suggested (see Avery Jones 1986, 78) that, were US: October 16 1974 *Boulez* (see Chapter 8.19) an Article 3(2) case (as it partly was, and as Körner J. thought it was – albeit in relation to the wrong Article), Germany should have accepted the erroneous US characterisation of the royalties paid to Boulez as being income from labor. I can only ask: why?

The 1992 ALI Report (62, italics added) “takes no position on the proper interpretation” of Article 3(2), although it recommends that the residence State should, in some unspecified way, normally follow the source State's domestic law as regards the application of double tax relief, and as regards those of its definitions which conform “in some reasonable way to *commonly accepted international practices*.”

These italicised words hint at the sixth reason why this approach may not often find favour. This approach assumes, too readily, that the context does not otherwise require – and fails to stress sufficiently the importance of finding a bilateral, contextual meaning. It stresses the application of one State's (the source State's) *unilateral, domestic* meaning of a term – whereas references to unilateral domestic law should, as far as possible, be avoided (see Chapter 8.14).

If references to domestic laws are discouraged, the issue of whether priority should be given to source State definitions, or residence State definitions, will largely disappear – because *all* domestic definitions will apply less frequently and will be given less weight. The fewer the references to domestic laws, especially *one* State's domestic laws, the more likely it is that uniform, neutral, autonomous meanings, free from interpretative difficulties, will evolve.

Even when domestic laws can be of assistance in interpreting the meaning of tax treaty terms, reference should be made not only to the domestic laws of *one* State (typically the State applying the treaty) but to the domestic laws of *both* States – because what is being interpreted is a term in a treaty between *two* States. Any domestic definitions should only govern to the extent that they are consistent with the common understanding of *both* treaty partner States – i.e. when they are consistent with the ordinary meaning of the tax treaty terms in their bilateral tax treaty context. If this approach is adopted, excessive and inappropriate references to *one* State's domestic laws should much decreased – and attention should focus on the need to find a contextual meaning.

This approach is consistent with Article 3(2) of the 1977 and 1992 OECD Models – which provides that the domestic law of the State applying the treaty is not to define undefined terms where “the context” otherwise requires (see Chapter 7.06).

This approach is also consistent with the second sentence of Para. 12 of the 1992 Commentary on Article 3(2) of the 1992 OECD Model which, also as indicated in

Chapter 7.06, defines “the context” as including (*italics added*): “... the meaning ... in the legislation of the *other* Contracting State”. Accordingly, the domestic law of the State applying the treaty will not define an undefined term if, *inter alia*, “the meaning given to the term in question in the legislation of the *other* Contracting State” otherwise requires. In this event the meaning of this term in the other Contracting State will typically apply – unless the context otherwise requires.

To summarise: courts and tax authorities in different States should search for contextual meanings – which, hitherto, they have rarely done. Their findings may differ – but such differences should decrease as contextual meanings are thoroughly researched. The existence of such (hopefully decreasing) differences is preferable to forcing a residence State to accept a source State’s (possibly incorrect) definitions. This summary is elaborated on in Chapters 10.01 and 10.13.

8.21 What “law” applies if States’ laws cannot apply?

But what if “the context” *does* require the non-application of the law of the State applying the treaty *and* of the law of the other Contracting State? If a term in a tax treaty is undefined, and if no State’s domestic law should be applied to define it, what “law” can be applied?

This seemingly unanswerable question ignores a tax treaty’s autonomous and dual status as a treaty and as domestic law – see Chapter 1. This status means that no “law” in one (or the other) State may be capable of governing the meaning of every tax treaty term. International tax language in a tax treaty can, and often should, be given an autonomous, contextual, meaning – consistent with the common intention of both treaty partner States (see Chapter 5). In practice, of course, this contextual meaning will already have been ascertained at the time it is decided that no State’s domestic law should apply – because the tax treaty context otherwise requires (see Chapter 7.14).

8.22 Which State’s laws should govern characterisation conflicts?

There is no suggestion in Article 3(2), or in its 1977 or 1992 Commentary, that a residence State has to accept a source State’s definition of undefined terms – see Chapter 8.20.

Similarly, Article 23 of the 1977 and 1992 OECD Model does not require a residence State to accept a source State’s definition of undefined terms – or its characterisation or quantification of income or assets.

Article 23 does not require a residence State to exempt (or give a credit for source State tax on) all income or capital which is taxed by the source State – but only such income or capital as is taxed in the source State *in accordance with the provisions of the Convention*. (The argument that the residence State has to accept that the source State must have taxed in accordance with the provisions of a Convention, *because* it contains an Article 3(2) and an Article 23, predicates the validity of the very point at issue – a *petitio principii*). Accordingly, the residence State must *itself* apply a tax treaty to determine whether, for example, it considers that the source State has taxed in

accordance with this treaty – because only in this case is it obliged to give an exemption or credit.

Para. 34 of Commentary on Article 23 of the OECD 1992 Model expressly recognises the impracticability of residence States having to undertake investigations of the actual taxation position in the source State. Para. 34 runs: “34. The State of residence must accordingly give exemption whether or not the right to tax is in effect exercised by the other State. This method is regarded as the most practical one since it relieves the State of residence from undertaking investigations of the actual taxation position in the other State.”

However, Avery Jones considers (1993B, 54): “... the Commentary did not have in mind at this point the possibility of the categorisation being different in each State”, being primarily concerned with “details of actual tax payments, rather than the categorisation of the income.”

There is some judicial support for the view that a residence State should accept a source State’s quantification and characterisation of income and assets.

For example, in Canada: December 14 1987 *Chhabra* (Article 6) Cullen J. rejected the Canadian tax authorities’ argument that a resident of Canada, who had elected under Article XIII A of the 1942 US tax treaty to be taxed on his US real estate income as if he were engaged in trade or business in the US, had to calculate this US income in accordance with Canadian tax rules. Cullen J. commented (88 DTC 6024): “... by requiring that rental income and capital gain be calculated in accordance with Canadian tax rules, the M.N.R. is in effect indicating that the provisions of the *Income Tax Act* should prevail over the Canada–US 1942 Tax Convention. This conflicts with the established notion that the provisions of a tax treaty should prevail and that the treaty should be interpreted liberally.”

As regards this comment Stikeman noted (1988, 2806): “... this interpretation of Article XIII A goes beyond the wording of the article.” Cullen J.’s comment is best regarded as *obiter*, because he had held that the US figures in question could not be considered manifestly erroneous and compared favourably with the Canadian tax authorities’ unsubstantiated figures – see Chapter 28.04.

The traditional view is that a State must itself apply its domestic law to quantify and characterise income and assets – even in a tax treaty context.

For example, Germany: *July 31 1974 BFH* (Article 23) held that, pursuant to a provision comparable to Article 3(2) of the OECD 1963 Draft in the 1954 US tax treaty, German domestic law was to determine whether salary income had a US source.

Similarly, Germany: *June 4 1991 BFH* (Article 10) held that the German book value of foreign shareholdings limited the amount of Swiss withholding tax which was creditable on a deemed distribution, for Swiss (withholding) tax purposes, of these shareholdings.

Again, US: LR 82-51-014 (Article 18) provides (*italics*, other than case names, added): “In the application of US income tax laws, *the concepts established by that body of law are controlling*, despite the fact that a particular transaction under

consideration may have had its origin in a foreign country and, to that extent, may have been affected by a foreign income tax law. See *Mary Duke Biddle v. Commissioner*, 302 U.S. 573, Ct. D. 1303, C.B. 1938-1, 309; *Edward D. Utermeyer v. Commissioner*, 59 Fed. 2nd 1004, Ct. D. 644, C.B. XII-1, 157 (1933), affirming 24 B.T.A. 906 (1931), certiorari denied, 287 U.S. 647 (1932).”

Using US concepts of income taxation to analyse described transactions, LR 82-51-014 holds that the capital repayment element in an annuity is not taxable in the US – even though the US has the right to tax this sum under the 1942 Canada tax treaty, and even though the annuitant had obtained a tax deduction in Canada for the cost of the annuity.

When a State applies its domestic law in this way in a tax treaty context, it applies it in exactly the same way as it applies it in a non-treaty context. The tax treaty position thus mirrors the position under pure domestic law when no tax treaty applies.

For example, State A will typically only have to exempt (or give a credit for tax on) what *it*, State A, considers to be foreign source (State B) income – and not what foreign State B might regard as local (State B) income. A contrary rule results in State A ceding its sovereignty to tax to foreign States – a result which it is difficult to imagine any State intending. Thus UK: *Yates v. GCA International Ltd.* ([1991] STC 157) held that, for UK foreign tax credit purposes, the amount of foreign income which is sourced abroad has to be determined by UK tax law – and not by the law of the source State (in this case, Venezuela).

However, if a residence State and a source State each apply their own domestic characterisations in a tax treaty context, double taxation (or double non-taxation) can arise when these characterisations conflict. In this event, should the laws of the source State, or the laws of the residence State, govern? This general question is comparable to, but should be distinguished from, the particular question (discussed in Chapter 8.20) of whether Article 3(2) of the 1977 and 1992 OECD Models requires a source State’s definitions to govern the meaning of undefined terms. So far, neither question has been addressed in OECD Models or their Commentaries.

Chapter 9 Evolving tax treaty terms and changing domestic laws

9.01 *The principle of contemporaneity*

The original meaning of a (tax) treaty term is its meaning at the time the (tax) treaty is concluded. Under the principle of contemporaneity, this original (i.e. contemporaneous) meaning applies throughout the duration of a (tax) treaty.

Fitzmaurice described the principle of contemporaneity as “his sixth major principle” of treaty interpretation. He enunciated it as follows (1957, 212): “The terms of a treaty must be interpreted according to the meaning which they possessed, or which would have been attributed to them, and in the light of current linguistic usage, at the time when the treaty was originally concluded.” Rights (and obligations) arising under a treaty can only be validly determined (1957, 225): “... on the basis of the contemporaneous meaning of the treaty terms at the date of its conclusion and in the light of current usages and practices at the time.”

This principle of contemporaneity can be expressed in the negative. Thus, Fitzmaurice cites (1957, 226) Judge Levi Cameiro’s statement in the *Minquiers* case (1953 I.C.J. 91): “... an instrument must not be appraised in the light of concepts which are not contemporaneous with it.”

There is a simple reason for giving a tax treaty term its original (contemporaneous) meaning: this original meaning reflects what the contracting States agreed to at the time they originally concluded the tax treaty. Any attempt to substitute a “new” meaning for an original meaning runs the risk of undoing the agreement reached between the contracting States. As Fitzmaurice comments (1957, 226): “Not to take account of contemporary practice and circumstances, and to interpret such treaties according to modern concepts, would often amount to importing into them provisions they never really contained, and imposing on the parties obligations they never actually assumed.”

Article 32 of the Vienna Convention, which specifically includes the *preparatory* work of the treaty and the circumstances of its *conclusion* as supplementary means of interpretation, reflects the principle of contemporaneity.

The principle of contemporaneity thus flows from the principle that a treaty term must be given a meaning which reflects the *original* mutual understanding of all contracting States – see Chapter 5. As the majority in Sweden: *December 23 1987 Supreme Court* (Article 13 and Chapter 5.05) held in relation to a provision comparable to Article 3(2) of the 1977 OECD Model (per Boström and Tyllström, 1993, 565 italics added): “... decisive above all in the interpretative process is what the intention of the contracting parties might have been *at the time when the provisions of the treaty were negotiated.*” Similarly, Switzerland: *June 22 1990 Bundesgericht/2* (Article 4 and Chapter 23.18) holds that the understanding of the Contracting States at the time they originally concluded a treaty is decisive.

The principle of contemporaneity is also an aspect of the need to consider treaty terms in their context – see Chapter 7. As Fitzmaurice comments (1957, 226 italics *not*

added): “ ... this principle is in a sense a special application of the principle of the natural and ordinary meaning *in the context in which the terms occur* ... ”

In a tax treaty context, the principle of contemporaneity is of particular relevance at the domestic level – because the rights and obligations of taxpayers vis-à-vis States (and vice versa) flow, in most cases, from the domestic law bringing the tax treaty into force. The original meaning of this domestic legislation may be the sole meaning endowed with the force of law domestically. Furthermore, as Ward has commented (1983, 606): “It is clear that at common law the rule is that in interpreting a statute, words are primarily to be construed in their ordinary meaning or common or popular sense, and as they would have been generally understood the day after the statute was passed. [Footnote 11: Halsbury’s Laws of England, 4th ed., Vol. 44 (London: Butterworths, 1973) para. 865, citing *Sharpe v. Wakefield* (1880), 22 QBD 239, at 241 (CA). Canada has the same rule: *Re Branch Lines, Canadian Pacific Railway Company* (1905), 36 SCR 42 at 90.]”

If, as in many States (such as the UK), a tax treaty is only cognisable by domestic courts once it has been incorporated into domestic law, it (or its meaning) can then only be changed by overriding domestic legislation – or by an amendment to the tax treaty (agreed to by both States) which is *also* incorporated into domestic law.

For example, whilst subsequent understandings between treaty partner States as to the meaning of tax treaty terms may bind these States at a public international level, they may not bind taxpayers at a domestic level. Accordingly, self-serving competent authority pronouncements, years after a tax treaty has been enacted, as to what these treaty partner States intended the original meaning of a treaty term to be, should be treated circumspectly – see Chapter 27.

Avery Jones *et al.* discuss (1984, 46) whether a tax treaty’s original meaning should be that applicable at the moment of its signature, ratification or entry into force. Other possible dates are a treaty’s effective date and the date of its incorporation into domestic law.

As between the treaty partner States themselves, the most appropriate date would seem to be the date of signature – because this is when they concluded their agreement. This would also seem to be the most appropriate date at a domestic level – even though a tax treaty may only be incorporated into domestic law some time after its signature. This is because what is being incorporated into domestic law is an existing agreement – the meaning of which has already been agreed.

In almost all cases this discussion will be academic – because a tax treaty’s original meaning will be the same at all the dates envisaged above. However, this point did arise in UK: July 16 1959 *Ostime* (Article 7 and see Chapter 26.15) – when the Revenue argued that the appropriate date was the date of signature (see Chapter 10.02).

The starting point for the interpretation of tax treaty terms must, therefore, be the original meaning of those terms at the time the tax treaty was concluded. What more logical starting point can there be? Avery Jones *et al.* have commented (1984, 41): “The treaty is easier to apply if one does not have to research what the law on a

particular subject was at the date of the treaty ...” Be this as it may, this effort clearly must be made – and I cannot conceive of more enthusiastic and authoritative researchers into original meaning than Avery Jones *et al.*

9.02 *The evolution of the ordinary meaning of a (tax) treaty’s terms during its life*

The principle of contemporaneity does not inhibit the evolution of international tax language, and does not involve the meaning of a tax treaty’s terms remaining “frozen” or “static” for the duration of its life – because no States ever intend this. As Sinclair commented at the 1985 IFA Congress (per Avery Jones 1985, 170): “The principle of contemporaneity would not require a static interpretation.” This is because Contracting States normally intend the meaning of treaty terms to follow the evolution of the law – and thus themselves evolve.

This presumption that the meaning of (tax) treaty terms may evolve is consistent with the principle of contemporaneity – because, at the time they *originally* conclude a (tax) treaty, the treaty partner States intend that the meaning of (tax) treaty terms should be capable of evolution. The issue, therefore, is not whether the meaning of a (tax) treaty term *can* evolve – it can, if this reflects the parties’ original intent – but whether the meaning of a (tax) treaty term *has* evolved. Evolution should only be permitted where this is consistent with the *original* shared expectations and intentions of the parties *at the time the treaty was originally concluded* – see Chapter 18.

At a public international level, there is a presumption that when States use a generic term in a treaty they intend this term to be capable of evolution.

Thus, in the *Aegean Continental Shelf* case, Greece argued that the meaning of the generic term “rights” in a 1928 treaty followed the evolution of the law. The International Court of Justice (ICJ) held (1978 I.C.J. 33): “If the Greek Government is correct, as it undoubtedly is, in assuming that the meaning of the generic term “rights” in Article 17 follows the evolution of the law, so as to be capable of embracing rights over the continental shelf, it is not clear why the similar term “territorial status” should not likewise be liable to evolve in meaning in accordance with “the development of international relations ... ” ”

The ICJ held that because, *at the time the treaty was originally signed*, “territorial status” was used (1978 I.C.J. 32): “as a generic term denoting any matters comprised within the concept of territorial status under general international law, the presumption necessarily arises that its meaning was intended to follow the evolution of the law and to correspond with the meaning attached to the expression by the law in force at any given time.”

9.03 *The meaning of generic tax treaty terms can evolve*

Just as there is a presumption that the meaning of a generic treaty term is capable of evolution, so there must be a presumption that the meaning of a generic tax treaty term is capable of evolution – because the parties *originally* intended this.

The meaning of a generic tax treaty term is most likely to evolve in an area which is

itself likely to evolve – such as entertainment, athletics, technology and finance.

Article 17 of the 1977 OECD Model applied, *inter alia*, to “artistes and athletes”. These generic terms were not defined in this Model or in its Commentary – but it must be presumed that OECD Members intended that these terms could evolve. The correctness of this presumption is borne out by the evolution of these terms after 1977.

Para. 5 of the 1987 OECD *Entertainers* Report (see Chapter 23.10) indicates that these terms should cover any person engaged, either individually or as a member of a group, in public entertainment or sporting activities. Para. 5 also notes that Article 17’s text and Commentary use the terms “artiste” and “entertainer” almost interchangeably.

Para. 71 of this Report implicitly recognises that the term “entertainer” may evolve – to include, at the least, those activities considered to be entertaining by the OECD Committee on Fiscal Affairs.

Thus, Para. 71 runs: “Article 17 also applies to other participants in public entertainment such as billiard players, and participants in chess or bridge tournaments.”. This comment may have been inspired by the holding in Italy: November 26 1981 Note (Article 17) that chess players are entertainers. Be this as it may, this comment is now echoed in Para. 6 of the Commentary on Article 17 of the 1992 OECD Model – which adds snooker to its (limited) list of entertaining activities.

This 1987 OECD *Entertainers* Report also recommended that the term “athlete” be changed to *sportsman* (italics added). In the 1992 OECD Model this change was made to the English text (only), the French term “sportif” remaining unchanged.

This change, doubtless made to clarify that Article 17 does not only apply to those involved in traditional athletic events (such as running, jumping and swimming), confirms that the terms “athlete” and “sportsman” are just as capable of evolution as the terms “artiste” and “entertainer”. This is demonstrated by Para. 5 of the 1992 OECD Commentary on Article 17 – which now specifically characterises golfers, jockeys, footballers, cricketers, tennis players and racing drivers as “sportsmen”.

The terms “athlete” and “sportsman” should, therefore, now also include a person undertaking sporting activities which those responsible for drafting the 1977 OECD Model were most probably unaware of – such as freestyle skiing, synchronised swimming and windsurfing (which all evolved into Olympic sports after 1977).

The evolution of transportation technology brought about by containerisation is evidenced in Germany: February 26 1969 Hamburg Ruling, Netherlands: September 16 1975 Ruling, US: Rev. Rul. 74–92 and US: Rev. Rul. 76–568 (all Article 8). These Rulings hold that transportation income from the operation of ships should henceforth include transportation income from specified container operations.

The evolution of computer and communications technology is also likely to lead to an evolution in the meaning and scope of tax treaty terms – notably royalties (see Chapter 8.13).

Rapid and fundamental evolutions in international finance have already led to a change in the definition of royalties. The huge growth in the leasing of equipment, notably big ticket items, led the OECD Committee on Fiscal Affairs to recommend in

Para. 23(a) of its 1985 *Equipment Leasing* Report (see Chapter 23.10) that income from leasing equipment should be excluded from the definition of royalties in Article 12 of the 1977 OECD Model – even though such income had been included in this definition only eight years earlier. In line with this recommendation, the 1992 OECD Model deletes the words “or for the use of, or the right to use, industrial, commercial or scientific equipment” in its Article 12(2).

Other evolutions in international finance are also likely to lead to evolutions in the meaning of other tax treaty terms. Novel derivative financial techniques, such as interest rate (and/or currency) swaps and stock lending (see LR 88–22–061 – Article 7), raise complex interpretative issues. For example, should a substitute payment for a dividend on loaned stock be characterised as a dividend, a business profit, interest – or “other income”? Whatever the answer(s) to this question – and different answers may apply in different States under their differing domestic laws – it shows that the meanings of tax treaty terms can, and must, evolve.

An example of a broader generic term in a tax treaty is each State’s “law” for avoiding double taxation. Domestic laws avoiding double taxation must normally apply in their current form if they are to be effective – and the 1977 and 1992 OECD Models recognise this (see Chapter 9.08).

9.04 *Domestic legislation may change the meaning of terms in future tax treaties*

If an event (for example, new legislation) changes a hitherto accepted interpretation of a tax treaty term, this “new” meaning may apply to tax treaties concluded after this event took place, whilst the “old” meaning may continue to apply to tax treaties concluded before this event took place. As always, the context should determine whether the “new” or “old” meanings should apply – see Chapter 7.

Thus, although a change in domestic law after a tax treaty was negotiated may not affect *this* treaty, the same change may affect its successor. This may result in an identical term in a later tax treaty being given a meaning different to that which it has in an earlier tax treaty.

The meaning of a tax treaty term may evolve, as regards a subsequent tax treaty, after a radical change in a State’s tax laws – because there is a presumption that treaty partner States must have been aware of such a change, and must have acquiesced to it, at the time the subsequent tax treaty was originally negotiated (see Chapter 24.01).

In Canada: January 25 1983 *Gadsden* (Article 13 and see Chapters 14.01 and 24.03) a UK resident appellant disposed of a life interest in a Canadian trust in 1976. Prior to 1972 such a disposition would normally have resulted in a capital gain, not taxable in Canada. However, a 1972 amendment to Canada’s Income Tax Act (paragraph 106(2)(b)) made this disposition liable to Canadian income tax.

The Tax Review Board held that the 1966 UK tax treaty, which was already in force when the 1972 amendment was enacted, protected the appellant from Canadian income (and capital gains) tax for as long as it remained in force. The 1972 amendment, which unilaterally deemed such a disposition to be of an “income” (rather than of a “capital”)

nature, could not alter its existing “capital” nature under the 1966 tax treaty.

However, the 1980 UK tax treaty offered the appellant no protection from an income tax charge. The Board rejected an argument by the appellant, based upon *Canada: March 12 1980 Associates* (Article 7 and Chapter 9.13) and *September 28 1982 Melford* (Article 7 and Chapter 10.08), that the Canadian Parliament had tried “to unilaterally restrict the application of the 1980 Convention with respect to a UK resident by altering the true legal fiscal nature of an income life interest in a trust”.

Mr. Tremblay held (83 DTC 135 and 136): “... it is impossible to contend that Canadian Parliament attempted to restrict the application of the 1980 Convention since the said Convention was not in force when paragraph 106(2)(b) was adopted. The Board shares the opinion of the respondent’s counsel that:

If the UK Government having full knowledge of the Canadian domestic tax laws at the time it signed the Convention did not see fit to negotiate with the Canadian Government for the inclusion in the convention of a provision to cover such cases, then one must conclude that the UK Government was satisfied with the situation.”

It is noteworthy that Tremblay J. did not refer to provisions comparable to Article 3(2) of the 1977 OECD Model in both the 1966 and the 1980 UK tax treaties.

9.05 *The evolution of tax treaty terms and Article 3(2) of the OECD Models*

The meaning of a tax treaty term is particularly likely to evolve when this meaning mirrors a definition in domestic law – because domestic law changes frequently.

Confusion has been caused by tax treaty provisions comparable to Article 3(2) of the 1977 OECD Model – to which OECD Commentaries paid scant attention until 1992. This unwelcome vacuum, however much it may have been abhorred by practitioners, encouraged much debate as to the meaning of Article 3 (especially Article 3(2)) – see Avery Jones *et al.* (1984), Tixier (1985) and Vogel (1986 and 1991).

Because it is somewhat unclear, the 1992 OECD Commentary on Article 3(2) will not silence this debate (see, for example, Avery Jones 1993A, 252). Some (though not I) view this Commentary with the disdain with which great chefs might view a hot dog.

Typically, this debate has involved three issues – which have not been sufficiently differentiated.

The first issue is the meaning of the words “the context” in Article 3 of the 1977 and 1992 OECD Models. As Chapter 7 argues, a tax treaty term – international tax language – must be given the meaning it has in its international tax treaty context. This meaning can override Article 3(1) treaty definitions (which are often immature) and Article 3(2) domestic definitions (which are often inappropriate).

The second issue is whether, and to what extent, domestic definitions should govern the meaning of tax treaty terms. As Chapter 8 argues, this issue is again dependent on the context of the tax treaty terms in question. In some cases, the tax treaty’s context requires domestic definitions to be applied. In most cases, however, references to domestic laws should be avoided to the extent possible.

The third issue is whether tax treaty terms should always be given their original

meaning at the time the treaty was concluded – or whether this original meaning may evolve. This issue is particularly delicate when domestic definitions of treaty terms change. Once again, as explained below, this issue is dependent on the context of the treaty (which will embody the parties' original intentions).

As regards this third issue, debate has focused mostly on whether undefined terms must be given the meaning they had under domestic law at the time a tax treaty was concluded (a "static" or "frozen" meaning) or whether they must be given the meaning they have at the time the issue arises (a "dynamic" or "ambulatory" meaning).

Both the static and the dynamic approaches suffer from defects.

A static approach is too rigid – because it does not allow tax treaty language to "breathe" and adapt to changing circumstances. As a result, the longer a tax treaty subsists, the less the likelihood of it being capable of interfacing satisfactorily with States' domestic laws – and hence of fulfilling its primary purpose of avoiding double taxation (see Chapter 11.01). The parties to a tax treaty could never have originally intended that a tax treaty should become less and less effective over time.

A dynamic approach will typically involve the excessive application of domestic law – and references to (changing) domestic definitions are to be discouraged, not encouraged (see Chapter 8.14). A fully dynamic or ambulatory approach is likely to lead to uncertainty and asymmetry in the interpretation, application and effect of tax treaties. It may also lead to double taxation and/or no taxation at all. The parties to a tax treaty could never have originally intended that the meaning of tax treaty terms should be capable of unlimited changes or ambulation.

Accordingly, even the most enthusiastic proponents of the dynamic or ambulatory approach recognise that it must be subject to some limitations. Thus, Avery Jones *et al.* favour (1984, 48) "the ambulatory interpretation, coupled with what we have called the express or implied limitation".

There is, indeed, one limitation to which the ambulatory approach must be subject – it can never have been intended that Article 3(2) should be a licence to override a tax treaty. A State cannot justify a change in its domestic law which overrides a tax treaty on the grounds that a fully ambulatory approach permits the application of this changed law. As explained in Chapter 9.11, Article 3(2) can never have been intended to permit a State to unilaterally breach a tax treaty obligation. To make this same point in a different way: Article 3(2) can only have been intended to permit the application of one State's changed domestic laws to the extent that the context of the tax treaty does not otherwise require. Once again, the context of a tax treaty is all-important.

By providing that *no* domestic definition (static or ambulatory) shall apply where *the context* otherwise requires, Article 3(2) emphasizes that *the context* should ultimately determine the meaning of a tax treaty term – and that both the static and the dynamic/ambulatory approaches may often be inappropriate.

I therefore favour an approach which I call the evolutionary approach.

The evolutionary approach is based upon the fundamental principle that the meaning of terms in a bilateral treaty must reflect the original common intention of *both* States

(see Chapter 5). This fundamental principle has hitherto been largely obscured by the intensity of the debate as to the relative merits of static, dynamic, and “ambulatory though coupled with limitations” approaches. However, thankfully this obscurity has not been total. For example, Hinnekens has sagely commented (1986, 210, in translation): “The only thing which must be assured when such an evolutionary interpretation is applied, is the necessary respect of the context, the principles of the treaty and the balance of the reciprocal concessions made by the parties.”

However, now that this principle is (obliquely) referred to in the OECD’s 1992 Commentary on Article 3(2) of the 1992 OECD Model, it should henceforth be given the recognition it has long deserved.

9.06 The evolutionary approach to the meaning of tax treaty terms

The evolutionary approach accepts that an original tax treaty meaning may evolve – but only to an extent consistent with the original intention of both treaty partner States. Under this approach, the issues of whether a tax treaty term should continue to be given its original (or static) meaning, whether the original meaning of a tax treaty term has evolved, and whether the meaning of a bilateral tax treaty term has changed a result of changes in one State’s domestic law, are wholly dependent upon the *original* common intention of both contracting States. This evolutionary approach gives the contractual nature of a tax treaty the recognition it deserves – yet enables it to remain effective in practice for years after it has been signed. Hence the adjective “evolutionary” – more flexible than static, less volatile than dynamic and, if nothing else, more elegant than “ambulatory ... coupled with limitations”.

Under the evolutionary approach, the starting point of interpretation can only be that mandated by the principle of contemporaneity (see above): namely, the original meaning of a tax treaty term, expressing the original intention of both treaty partner States.

The fact that this original meaning is the starting point of interpretation does not, however, result in the meaning of a treaty term having to remain static for all time. This meaning must be allowed to evolve – in line with *both* parties’ original intentions.

The question then arises: what did the parties originally intend?

When a tax treaty mandatorily *requires* domestic law to govern the meaning of one of its terms, the parties must have originally intended that the current definition in domestic law should normally apply – because a tax treaty will only remain effective if such a current definition does apply. Accordingly, when a mandatory domestic definition changes, its mirror-image tax treaty meaning will also normally change.

However, references to domestic law should be avoided to the extent possible – see Chapter 8.14. The rarer the references to domestic law, the less frequently will changes in domestic law affect the meaning of tax treaty terms.

9.07 When domestic definitions must apply, they must normally be current

The 1977 and 1992 OECD Models only *require* domestic definitions to be applied

when this is axiomatic (nationality, political subdivision, local authority etc.), necessary (a resident) or helpful (immovable property) – see Chapters 8.01 to 8.06. (Dividends are discussed below.) If a tax treaty is to remain effective, these definitions must normally be those current at the time a dispute arises – and not those originally applicable when this tax treaty was first concluded. It must be presumed that this was the original intention of the parties.

For example, because the status of nationality can only depend upon the law of the State conferring it, and because this law may change, the tax treaty meaning of a State's "national" must normally mirror any changes in its domestic law. If a tax treaty meaning of a national does not mirror that applicable under domestic law at the time a dispute arises, the treaty will almost certainly cease to be effective.

Similarly, the meaning of a political subdivision or local authority of a State must normally also mirror any changed definitions of these terms in its domestic law.

Again, if Article 4 of the 1977 OECD Model is to be effective, the applicable domestic residence laws must normally be those in force at the time a dispute arises. This is probably why, when the UK's definition of corporate residence was changed in 1988 so as to deem companies incorporated in the UK to be resident there, no indication was given by the UK Revenue that tax treaty amendments were required.

Article 4's tie-breaker rules must, similarly, cover any person deemed to be a resident under any domestic law. The need for a tax treaty to *always* attribute a sole residence for tax treaty purposes may, indeed, be particularly necessary when domestic definitions of residence change. The tax treaty meaning of a resident must, therefore, normally mirror any changes in domestic law. As Avery Jones *et al.* cogently observed (1984, 34): "It would be impossible to apply the treaty to people who were or were not resident under a definition which was no longer applicable."

Again, because the tax treaty meaning of immovable property must always mirror definitions of this term in the domestic law of the State of situs, any changes in this domestic law must normally be reflected when the tax treaty is being applied.

Article 10(3) of the 1977 and 1992 OECD Models also defines dividends by reference domestic laws – specifically, the laws of "the State of which the company making the distribution is a resident". However, this reference to domestic law was made reluctantly – see Chapter 8.11. Accordingly, although each State's current domestic law should normally still be applied to define dividends, this requirement may change in the future.

Several definitions in Article 3(1) of the 1977 and 1992 OECD Models also contain terms which can only be interpreted by reference to a domestic system of law – so that when these domestic definitions change, the meaning of these treaty terms will normally also change (unless the context otherwise requires). For example, as Chapter 8.07 indicates, Article 3(1) of the 1977 and 1992 OECD Models and its Commentary define a company by reference to the tax laws of the State in which it is organised. When these laws change, treaty meanings will normally also change.

Thus, Netherlands: *September 18 1985 HR* (Article 16) holds that although the 1970

Belgium tax treaty only referred to a corporation (NV), this term was capable of evolving to encompass a limited liability company (BV) – even though a BV only came into existence after 1970. Such evolution was permissible because a BV was, from a Netherlands tax point of view, virtually indistinguishable from a NV.

9.08 Domestic laws avoiding double taxation must normally apply in their current form

When a tax treaty obligates one State to avoid double taxation, and permits the other State to tax, it allows each State's domestic law to apply. In the absence of any indication to the contrary (see below), the domestic law which should apply will normally be current domestic law – to the extent that it is consistent with the context of the tax treaty. The application of such current domestic law is wholly independent of a provision comparable to Article 3(2) of the 1977 and 1992 OECD Models; it derives its applicability from the treaty Articles obligating States to avoid double taxation or permitting them to tax.

Tax treaties therefore often refer to the domestic laws by which States fulfil their tax treaty obligations to avoid double taxation. These laws change frequently – and if they change, they should normally apply as changed. The fact that laws for avoiding double taxation should apply as they evolve is implicitly recognised by the fact that the Commentary on Article 23 of the 1977 and 1992 OECD Models, which leaves many issues in this area to be resolved by domestic laws, never contemplates that changed domestic laws may not apply.

For example, Para. 60 of the 1977 and 1992 Commentary on Article 23 provides: "Article 23B sets out the main rules of the credit method, but does not give detailed rules on the computation and operation of the credit." These detailed rules are to be laid down by domestic law; States not having them are to enact them. These laws, and comparable laws in States applying the exemption method, can clearly change from time to time.

The same result can be reached by accepting that each State's "law" for avoiding double taxation is a generic tax treaty term, and that the parties must have *originally* intended that this term should be capable of evolution – see Chapter 9.03.

As Timmermans has commented (1993, 454 and 455), in Netherlands: *November 27 1986 HR* Attorney-General Van Soest referred to the meaning of the generic term "Netherlands law" for avoiding double taxation in Article XIX(3) of the 1948 US tax treaty. Van Soest opined: "If such a generic term is laid down in a treaty, the inclusion of those stipulations [referring specifically to the original Netherlands law], or even the mention of the stipulations would appear to have been avoided deliberately. I consider it possible that there is more to this than indolence alone. The method has the clear advantage, for instance, that all Dutch taxpayers are treated equally in this way. This advantage is retained through ambulatory interpretation. The argument against the ambulatory method, that it allows a State to unilaterally alter the application of the treaty, seems to me to be a *petitio principii*; if the ambulatory interpretation is the correct one, the power for such action is incorporated in the treaty."

In other words, Van Soest correctly concluded that parties to a tax treaty using a generic term originally intended the meaning of this term to be capable of evolution – to the extent permitted by the context.

9.09 *However, the parties may intend that some original meanings should always apply*

In some cases the parties to a tax treaty may originally intend that (original) domestic laws should invariably apply.

For example, Section 3 of the Protocol to the 1989 Netherlands/Zimbabwe tax treaty provides that the 1981 Zimbabwe Capital Gains Tax Act “as in force at the date of signature of this Convention” shall always apply to specified transfers for the purpose of applying this treaty’s Capital Gains Article 13.

Similarly, Para. 8(b) of the Protocol to (Article 22 of) the 1993 Russia/US tax treaty runs in part: “In the event that the Russian law “Tax on Profit from Enterprises and Organizations” (or a substantially similar profits tax law) ceases to be in effect, such resident will be permitted to continue to compute its tax in the manner stipulated by such law ...”

US: LR 78-44-008 (Article 7) discusses an arguably comparable provision in the defunct 1956 Honduras tax treaty – see Chapters 9.17 and 10.05.

Some older US tax treaties specifically provided that the applicable US domestic law for avoiding double taxation should always remain the original law (i.e. that in force at the time the treaty was concluded).

Thus, Article XV of the 1942 Canada/US tax treaty originally provided that the US would avoid double taxation “in accordance with the provisions of section 131 of the US Internal Revenue Code *as in effect on the day of the entry into force of this convention.*” US: May 10 1948 *Freudmann* (Article 23) held that, in view of Article XV’s specific reference to s.131 IRC, s.131 IRC was not only material, it was controlling – even though it did not avoid double taxation in that case.

Similarly, Article XIII(1) of the 1945 UK/US tax treaty originally provided that the allowable tax credit in the US would be subject to “sections 901 and 905 of the Internal Revenue Code as in effect on the 1st day of January 1956” – see US: Rev. Rul. 80-243 (Article 7 and Chapter 7.05).

However, US tax treaties now typically incorporate foreign tax credit provisions in the Code “as it may be amended from time to time” (see US: Rev. Rul. 79-199 – Article 23). The 1942 Canada/US tax treaty was amended to this effect in 1950 – as was the 1945 UK/US tax treaty in 1966.

As amended in 1950, Article XV of the 1942 Canada/US tax treaty provided for US tax to be creditable “in accordance with the provisions of The [Canadian] Income Tax Act”. Canada: April 1 1968 *Interprovincial* (upheld as “the last word on the subject” in October 7 1968 *Snell* – both Article 23) held that this amendment meant that US taxes were creditable in accordance with the current provisions of this Canadian Act as in force at the time these US taxes were paid.

The 1981 US Model provided that the applicable US law for foreign tax credit

purposes is current US law. Article 23 of this Model defined this law as: “the law of the US (as it may be amended from time to time without changing the general principle hereof) ...”

9.10 Domestic laws imposing taxation must normally apply in their current form

Just as domestic laws avoiding double taxation should normally apply in their current form (see Chapters 9.08 and 9.09), so domestic laws imposing taxation should normally apply in their current form – in line with the original intention of both treaty States.

Except as regards dividends and interest (which a source State may subject to limited rates of tax) the OECD Models have never sought to influence the existence, extent or level of tax in each State – except in the case of discrimination. They simply seek to govern the allocation of the right to tax. To the extent that a State is allocated a right to tax by a tax treaty, it can exercise its sovereign right to tax as it wishes. To the extent that a State is free to tax as it wishes, it is free to change its tax régime at any time.

This right to tax – and to change – derives from the tax treaty Articles allocating the right to tax. Once again, this right to tax – and to change – is wholly independent of any provision comparable to Article 3(2) of the 1977 and 1992 OECD Models.

Several provisions in the 1977 and 1992 OECD Models accept, inevitably, that States may change their tax laws after a tax treaty has been concluded.

For example, if a State imposes a new tax after a tax treaty is signed, this “new” tax could not, by definition, have been included in the list of taxes covered by this treaty – because it was not in existence at the time this treaty was concluded. However, the parties will typically intend this treaty to cover new taxes which are “substantially similar” to those already covered by it. To accomplish this, Article 2(4) of the 1977 and 1992 OECD Models begins: “4. The Convention shall apply also to any identical or substantially similar taxes which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes.”

Thus, when Ireland changed its system of corporation tax in 1976, US: LR 87-33-041 (Article 23) and LR 89-31-070 (Article 2) held that because these new taxes were “substantially similar” to those imposed under Ireland’s former system, foreign tax credits would remain available for these new Irish taxes.

More controversially, France: *January 17 1985 Paris TGI* (Article 2) held that the 1959 Austria tax treaty covered a French wealth tax introduced by the November 30 1981 Law No. 81-1160 – even though this tax was, perforce, not included in the list of French taxes specifically covered by the treaty. The TGI noted that the treaty covered *Austrian* wealth taxes – and was to “apply to any other identical or similar taxes which are imposed by *either* Contracting State after the signature of the Convention” (italics added). Accordingly, a resident of Austria was (unusually – see Article 22 of the 1977 and 1992 OECD Models) protected from French wealth tax on French immovable property. In a November 21 1985 Instruction the French tax authorities acquiesced to *January 17 1985 Paris TGI* – and extended its application to 21 similar treaties (see

Chapter 24.07).

The freedom of States to change their tax laws after a tax treaty is concluded is confirmed by the last sentences of Article 11(6) and Article 12(4) of the 1977 and 1992 OECD Models. They provide that “the excess part of the payments [of “interest” and “royalties” respectively] shall remain taxable according to the laws of each Contracting State ...”

Similarly, Para. 11 of the Commentary on Article 13 of the 1977 and 1992 OECD Models runs in part: “It is, of course, left to each State to decide whether or not such gains should be taxed.” Clearly, if a State is free to decide whether or not to tax, it is equally free to change its tax laws.

To summarise: a State’s right to change its tax régime derives from the treaty Articles allocating the right to tax, and is wholly independent of any provision comparable to Article 3(2) of the 1977 OECD Model. Although Article 3(2) may be relevant in determining whether a right to tax exists in the first place, it is not relevant once this right has been established.

Several decisions and rulings have, nevertheless, confused this freedom of a State to change its tax régime with the extent to which changed domestic laws may determine the meaning of tax treaty terms – and, hence, the right to tax itself. As explained in Chapter 10.04 onwards, such confusion is manifest in US: LR 78-44-008 (Article 7) and comparable US Rulings; it is also evident in Canada: February 19 1992 *Utah Mines* (see Chapter 9.17) – because it considered LR 78-44-008.

9.11 *The presumption that tax treaties override subsequent changed domestic laws*

The alert reader will have noted that I often used the word “normally” in Chapter 9.07 onwards. I did so to highlight that, in the absence of specific provisions to this effect (see below), parties to a tax treaty can never have intended that one State’s changed domestic definitions should invariably apply – because some changed definitions may be inconsistent with the context and substance of a tax treaty, i.e. with the very basis of their agreement.

This possibility may be specifically recognised in a tax treaty. For example, Article 3(1)(k) of the 1975 UK/US tax treaty defines UK nationality by reference (necessarily – see Chapter 8.02) to, inter alia, the British Nationality Acts of 1945 and 1971. These provisions are to apply in so far as they are (italics added): “... in force on the date of entry into force of this Convention or have been modified *only in minor respects* so as not to affect their general character; ...” Current UK definitions are thus to apply – unless they contain major modifications.

Similarly, a new excessively wide definition of dividends by the State where the distributing company is resident, which could never have been contemplated by its treaty partner State, should not normally apply – because it amounts to an override of the tax treaty. A comparable argument could also be made as regards immovable property – as discussed in relation to the 1989 OECD *Override* Report, notably its Case 2, in Chapter 10.01.

Accordingly, there is a presumption that changed domestic definitions should not apply to the extent that they are inconsistent with a tax treaty. In line with this presumption, many States have enacted specific legislation to provide that, to the extent that domestic law is inconsistent with a tax treaty, the tax treaty shall prevail. As indicated in Chapter 9.12, Canada is one such State. Australia (see Chapter 10.03), New Zealand and the UK are others.

This presumption clearly applies if a tax treaty does not contain a provision comparable to Article 3(2) of the 1977 OECD Model. Furthermore, as I argue in Chapter 10.01, it also applies if a tax treaty does contain a provision comparable to Article 3(2) – because Article 3(2) can never have been intended as a licence to override. This is one reason why Article 3(2) provides that domestic definitions are only to apply where the context does not otherwise require.

The argument that changed domestic definitions should not apply when they are inconsistent with a tax treaty which does not contain a provision comparable to Article 3(2) of the 1977 and 1992 OECD Models has been made in numerous Canadian decisions which are now analysed. These decisions all involve the 1942 Canada/US tax treaty.

9.12 Canada: July 3 1975 *Shahmoon* (Article 5) and February 3 1982 *Abed* (Article 3)

Shahmoon and *Abed* both involved US residents making gains on sales of Canadian immovable property. In common with all the other Canadian decisions analysed below, these two decisions involved the 1942 US tax treaty – which did not contain a provision comparable to Article 3(2) of the 1977 OECD Model.

s.3 of the Act bringing this treaty into force in Canada provided: “In the event of any inconsistency” between the treaty and “the operation of any other law” the provisions of the treaty “shall, to the extent of such inconsistency, prevail.”

Shahmoon held that such gains were not taxable in Canada – because the vendor was not a resident of Canada and had no permanent establishment there. The Chairman of the Tax Review Board did not, therefore, have to address the vendor’s argument (75 DTC 277 and 278): “... this Convention dates back to 1942 at which time the now well-worn phrase “Adventure in the nature of trade” became part of our income tax law, and therefore any gain that was made was treated as a “capital gain” in the US, and this country should not, and cannot, unilaterally change the connotation of whatever was known by that term in 1942 when the Convention was signed.”

In *Abed*, the vendors advanced a comparable argument (82 DTC 6102): “30. A further argument is invoked under Article VIII of the Convention. A resident of the USA is not subject to tax on capital gains in Canada provided such resident has no permanent establishment here. It is acknowledged that, by virtue of the extended definition of “business”, the assessment does not purport to treat the gain as being on capital but only on income account. However, this extended definition only came into operation in 1949 under which the adoption of the term “adventure or concern in the nature of trade” substantially enlarged the ambit of the kinds of transactions the profit

from which were subject to income tax (*M.N.R. v. James A. Taylor*, 1956 Canada Tax Cases 189 at p. 210). At the time of the adoption of the present Convention in 1942, both Canada and the US understood that the type of transaction presently under consideration was on capital account. In the US in the taxation years under review, the gains were still considered to be capital gains. It is not open to one of the parties to the Convention to change the meaning by a unilateral act through changing the meaning of the expression “capital assets” as it was adopted in 1942 and as it continued to apply in the taxation years under review.”

Supposedly addressing this argument, Pratte J. held (82 DTC 6102): “The answer to that argument, in my opinion, is that article VIII applies to “gains derived ... from the sale ... of capital assets” and that the meaning of that phrase, in Canadian law, has not changed since the date of the Convention. The fact that the expression “business” is now defined so as to include “an adventure or concern in the nature of trade” is irrelevant since, in this case, the purchase and sale of lots 128 and 278 were not isolated transactions but part of the carrying on of a business.”

Pratte J. thus held that because Abed had been carrying on a business of buying and selling immovable property, his gains had never been gains on the sale of *capital* assets. As a result, Pratte J. did not directly address Abed’s (arguably correct) argument that Canada could not unilaterally change the characterisation of his activities. Abed argued that these activities had originally generated capital gains in both States – and that, subsequently, Canada could not unilaterally deem them to generate business income (which was subject to less favourable tax treatment under the tax treaty). This change did reduce those activities which could generate gains from the sale of capital assets – and, arguably, *did* change the scope (and hence the meaning) of the treaty words “gains derived from the sale ... of capital assets”.

9.13 Canada: March 12 1980 Associates (Article 7)

In *Associates* it was agreed that guarantee fees paid in 1974 onwards by a resident of Canada to a resident of the US would normally be characterised as industrial or commercial profits. The 1942 US tax treaty exempted these profits from tax in Canada – because the US resident had no permanent establishment in Canada. At issue was whether a 1974 unilateral amendment to Canadian domestic tax legislation, which deemed these guarantee fees to be interest (and hence subject to withholding tax), should override this treaty exemption. As already indicated, the treaty did not contain a provision comparable to Article 3(2) of the 1977 OECD Model.

In the Trial Division Mahoney J. (whose opinion was adopted orally on appeal) held (80 DTC 6051) that although the definition of “interest” in the Protocol to the treaty was “not, by its terms, exhaustive”, it could not be “unilaterally expanded by Canada to embrace income that is not interest at all”. s.214(15)(a) of the 1972 Income Tax Act (as amended in 1974), which deemed guarantee fees to be interest, “is inconsistent with the Convention and by virtue of section 3 of the Act that makes the Convention part of Canada’s domestic law, paragraph 214(15)(a) cannot apply to guarantee fees subject to

the Convention. The fees in issue were a component of the Plaintiff's industrial and commercial profits which were not taxable by Canada since the Plaintiff was a US enterprise having no permanent establishment in Canada.

Lest it be thought that such a result renders paragraph 214(15)(a) a nullity, I should note that the tax conventions concluded by Canada since its enactment in 1974 all contain expanded definitions of "interest" which may well not be inconsistent with the paragraph. For example, the *Canada/France Income Tax Convention*, which became the domestic law of Canada July 29, 1976 (S.C. 1974-75-76, c. 104), contains, in Article XI, a definition of "interest" that includes "income assimilated to income from money lent by the taxation law of the State in which the income arises".

The issue in *Associates* also arose in Canada: September 28 1982 *Melford* (Article 7 and see Chapter 10.08) – when the Supreme Court reached a conclusion comparable to that reached in *Associates*. It did so even though, as in Australia: September 20 1977 *Sherritt Gordon* (Article 12 and see Chapter 10.03), the 1956 Germany tax treaty at issue *did* contain a provision comparable to Article 3(2) of the 1977 OECD Model. This supports the conclusion that Article 3(2) should not be interpreted as permitting domestic law to override a tax treaty.

9.14 Canada: July 12 1983 *Placements Serco* (Article 13)

Placements Serco applied *Associates* (and *Melford* – see Chapter 10.08). It also held that the 1942 US tax treaty precluded the application of a 1972 change in Canadian domestic tax legislation which deemed the excess of the purchase consideration over the paid up capital value of shares to be a dividend.

9.15 Canada: November 21 1983 *Krafve* (Article 13)

Krafve, a US resident, gave shares in a Canadian company to a Canadian trust (in favour of his children). He had bought these shares in 1976 for C\$2500 a share – but by the time this gift was made (in 1978) the value of each share was, according to Revenue Canada, C\$8000.

In an unusual example of a *taxpayer* arguing for a dynamic interpretation of a tax treaty term, the US resident argued that because the 1972 Canadian Income Tax Act (which introduced a capital gains tax in Canada) deemed a gift to be a disposition for capital gains tax purposes, his gift/disposition should be covered by Article VIII of the 1942 US tax treaty. He argued that Article VIII (which was intended to cover capital gains) should cover any event which generated a capital gain in either State.

However, Article VIII only exempted a gain on a "sale or exchange". Although the law reports give no indication that *Krafve's* counsel made the point, the words "sale or exchange" had been used in Article VIII because in 1942 (when the treaty was concluded) these were the only events that constituted a disposition for capital gains tax purposes in the US – the only one of the two States to tax capital gains at that time.

In the Tax Court Goetz T.C.J. dismissed the taxpayer's argument. He held (84 DTC 1004 and 1005): "I ... find that "sale" or the words "sale or exchange of capital assets"

mean just that. They do not include the word “gift” or “acquisition”. A gift is a conferred benefit.”

Article XIII(4) of the 1980 Canada/US tax treaty now covers gains from the “alienation” of any property. The US Technical Explanation, which Revenue Canada has indicated it will follow (see Chapter 25.06), provides that “alienation” means any “taxable events under the taxation laws of the Contracting State applying the provisions of the Article”. As the scope of these taxable events evolve so, presumably, will the meaning of “alienation”.

9.16 Canada: January 28 1985 *Gladden Estate* (Article 13)

Gladden Estate involves the same tax treaty terms as *Krafve*, and the two decisions provide a fascinating contrast. In *Gladden Estate* a US citizen and resident died owning Canadian shares. s.70(5) of the Canadian Income Tax Act deemed a deceased person to dispose of all his Canadian property immediately before death. Such a disposal could therefore generate a capital gain – which s.70(5) taxed as income (see Chapter 12.06).

The Estate argued that because Article VIII would cover a real capital gain on a sale or exchange, it also had to cover a deemed capital gain on a deemed disposal – even if Canada taxed this capital gain as income. Citing *Associates* (see Chapter 9.13) and *Melford* (see Chapter 10.08) the Estate argued that Canada could not vary the terms of a treaty by subsequent legislation.

In the Tax Court St-Onge T.C.J. held that this argument (84 DTC 1246): “... has no bearing since at the time of the agreement on Article VIII of the *Canada-US Tax Treaty* there was no tax on capital gain in Canada. ... So the parties could not have negotiated to avoid double taxation, on a tax which did not exist in Canada.”

The Estate’s appeal against this (and other) holdings by St-Onge T.C.J. was upheld by Addy J. He commented (85 DTC 5189): “The plaintiff argues that the intention of parties was obviously to exempt non-residents of each country from capital gains tax which that country might impose. Canada, in fact, did not have a capital gains tax at the time but the wording of Article VIII is quite clear. I therefore fail to understand the finding of the Tax Court below to the effect that because Canada had no capital gains tax it was not and is not bound by Article VIII. After quoting the article textually, the learned Judge summarily rejected the argument with which I am dealing in the following terms: “the parties could not have negotiated to avoid double taxation on a tax which did not exist in Canada.” It seems to be trite law that a person can contract in anticipation of the possible occurrence of a future event.”

Citing the Vienna Convention (see Chapter 24.01), Addy J. held it would be “unreasonable” and “absurd” for Article VIII to cover a real gain but not a deemed gain. Accordingly, he held that Article VIII protected the Estate from Canadian tax.

Contrast *Krafve* and *Gladden Estate*. Arguably, *Krafve* adopted a more literal and static approach than *Gladden Estate*. *Krafve* holds that a gift (a disposition for Canadian capital gains tax purposes) is not a sale or exchange. However, *Gladden Estate* holds that death (a deemed disposition for Canadian capital gains tax purposes)

is a sale or exchange.

9.17 Canada: February 19 1992 Utah Mines (Article 7)

Utah Mines involved amendments to s.18(1)(m) of the Canadian Income Tax Act. These amendments sought to prevent all taxpayers, including the Plaintiff (Utah Mines – a US corporation) from deducting, as a business expense, royalties which it had to pay to the Province of British Columbia in respect of mining operations carried on in Canada by its Canadian permanent establishment. This deduction had been available throughout the 1942 US tax treaty's existence.

In Walsh D.J.'s words in the Trial Division (91 DTC 5248): "Plaintiff submits that if paragraph 18(1)(m) of the Act were applicable to Plaintiff, it would deny the deduction of an amount deductible in accordance with generally accepted accounting principles and be inconsistent with the Convention and the *Tax Convention Act* since neither the treaty nor any other law of Canada applicable in the 1974 taxation year empowers Canada to unilaterally attempt to amend the Convention by means of a change in the domestic law which would preclude the operation of generally accepted accounting principles."

The Plaintiff invoked Canada: March 12 1980 *Associates* (Chapter 9.13) and September 11 1982 *Melford* (Chapter 10.08) (both Article 7) which hold that changed domestic laws should not apply to the extent that they are inconsistent with tax treaties.

In the Trial Division the Canadian tax authorities correctly distinguished *Associates* and *Melford* by pointing out that the royalty payments were allocable to the Plaintiff's Canadian permanent establishment – and that the expenses (and profits) of this establishment were completely within Canada's domestic taxing jurisdiction. The amendments to s.18(1)(m), which eliminated the deductibility of the royalty expenses, simply reduced the amount of the permanent establishment's profits.

In contrast, *Melford* involved a change in the meaning of a treaty word ("interest") so that, as Walsh D.J. commented (91 DTC 5249): "... a change in the meaning of the word in that agreement would necessarily mean a change in the Agreement itself. Furthermore, in *Melford* the provisions set out to circumvent a limitation contained in a tax treaty and was directed only at non-residents whereas in the present case, amendments to 18(1)(m) at issue in this appeal were directed at the manner in which all taxpayers calculated income under the Act and affected Canadian residents carrying on similar business activities under the same or similar conditions as it did non-residents protected by the Convention."

This argument should have been sufficient for the Canadian tax authorities to win their case. It should have demonstrated that, once Canada's right to tax profits had been established, any argument as to whether the meaning of tax treaty terms could change or evolve was irrelevant. However, Walsh D.J. did not make this point. He focused on the Plaintiff's irrelevant and inaccurate argument that the original meaning of the tax treaty's terms preserved the deduction, and on the Canadian tax authorities' irrelevant and inaccurate argument that the amendments precluding the deduction should be

given effect – because *all* changes in domestic law should be given full effect.

Walsh D.J. commented (91 DTC 5249): “With respect to the argument in Plaintiff’s statement of claim that the industrial and commercial profits are to be determined in accordance with concepts prevailing at the time of the coming into force of the Tax Convention which allowed at that time full deductibility from mining royalties paid to a province in Canada, Defendant submits that in the absence of definition of “industrial and commercial profit” this is not frozen for all time, by what was understood by it at the date of the Convention and that there are no expressed provisions in the Convention so limiting them. Within the jurisdiction of Canada the notion of profits whether industrial, commercial or otherwise both from an accounting and tax legislative perspective has never been established but has been and is still a concept that changes constantly. It is interesting to note that an extract from Michael Edwardes-Ker, *The International Tax Treaties Service* ... refers to ... [US: LR 78-44-008 – Article 7 ...]”.

As discussed in Chapter 10.05, Walsh D.J. cited extracts from LR 78-44-008 including its debatable holding: “... absent a clear intent to limit the internal law to that in force at the time of a treaty’s ratification, subsequent changes in internal laws should be given full effect.”.

Walsh D.J. had justifiable reservations about this misleading holding, as discussed below, but he did not make clear quite why this holding is misleading.

Walsh D.J. then concluded (91 DTC 5251) that an amendment to Canadian domestic law after the 1942 Canada/US treaty had come into force did not contravene the treaty – because it “was applicable equally to both domestic corporations and permanent establishments in Canada of US corporations”.

However, this conclusion does not make clear that the reason why this amendment did not contravene the treaty was because Canada’s right to tax the Canadian mining operations’ profits had already been established. Walsh J. should have held that subsequent changes in internal laws can be given full effect once a right to tax exists. Furthermore, effect should only be given to a change which seeks to determine whether a right to tax exists in the first place to the extent that this change is consistent with the substance and context of a tax treaty.

These propositions apply irrespective of a provision comparable to Article 3(2) of the 1977 OECD Model – which was not, in any event, present in the 1942 US tax treaty at issue in *Utah Mines*, but which was present in LR 78-44-008.

Walsh D.J.’s citation of LR 78-44-008, although as welcome as his acknowledgement of the source he relied upon, can confuse – because LR 78-44-008’s debatable holding that “changes in internal laws should be given full effect” was made (inaccurately, see Chapter 10.05) in relation to a provision comparable to Article 3(2). As explained above, such a provision is irrelevant once a right to tax has been established.

In the Court of Appeal Hugessen J.A. (expressing the opinion of the Court) came to the same conclusion as Walsh J. – but he did not focus on the issue of whether changed domestic law should apply. He focused on the purpose of the treaty: to avoid double taxation (see Chapter 11.01). He commented (92 DTC 6197): “Clearly that purpose

was not, as the appellant would have us believe, to create for enterprises doing business and having permanent establishments in both countries a separate and different system of taxation from that prevailing for taxpayers doing business in only one or other of them.” He continued (97 DTC 6197): “The interpretation adopted by the Learned Trial Judge gives effect to the purpose of the parties to the Convention and does no violence to the language used by them. The interpretation proposed by the appellant, on the other hand, would have the effect of giving a US taxpayer with a permanent establishment in Canada a more favourable tax treatment than its Canadian competitor engaged in the same business in this country. Such a result would not be in accordance with the policy expressed in the preamble to the Convention and indeed would be contrary to it.”

Utah Mines could have been decided more satisfactorily on the grounds that the US 1942 tax treaty, in common with other tax treaties, allocates the right to tax a permanent establishment’s profits to the State where this permanent establishment exists. Once a right to tax profits has been allocated to a State, it may tax these profits as it wishes – subject to any treaty-imposed limitations. Such limitations would include the requirement to avoid discrimination and, pursuant to Article III(1) of the 1942 US tax treaty, the requirement to allow deductions “reasonably allocable” to a permanent establishment. As the Federal Court of Appeal pointed out, a Canadian permanent establishment of a US corporation should not be able to deduct expenses which a Canadian company could not deduct.

The validity of this interpretation is supported by the fact that Article VII(3) of the 1980 Canada/US tax treaty now provides, in common with other Canadian tax treaties, that “... Nothing in this Paragraph shall require a Contracting State to allow the deduction of any expenditure which, by reason of its nature, is not generally allowed as a deduction under the taxation laws of that State.”

Chapter 10 Article 3(2) of the OECD Models and changing domestic laws

Chapter 9 concludes that provisions comparable to Article 3(2) of the OECD Models have often been misunderstood. They have often been cited as justifying changes in domestic law – when, in fact, the validity of such changes depends upon other treaty Articles. This conclusion is confirmed by the following analysis of Article 3(2)'s history – and the leading decisions and rulings on its impact (if any) upon the permissible evolution of the meaning of tax treaty terms.

10.01 *The genesis and evolution of Article 3(2) of the OECD Models*

The history and evolution of Article 3(2) clarifies whether it permits changed domestic laws to apply to a greater extent than would be the case were it not included in a tax treaty.

Article 3(2) of the 1977 and 1992 OECD Models runs (*italics added*): “2. As regards the application of the Convention by a Contracting State any term not defined therein shall, *unless the context otherwise requires*, have the meaning which it has under the law of that State concerning the taxes to which the Convention applies.”

This text casts little light on the issue of whether undefined tax treaty terms should be interpreted by reference to the (original) domestic law at the time this treaty was concluded – or any changed version of this law.

It is significant that Article 3(2) did not appear in any of the League Drafts. At that time, many pioneer international tax practitioners were convinced that the meaning of the “international tax language” in tax treaties should, and would, be determined by international or supranational courts – see Chapter 2.02.

Tax authorities were unenthused by this prospect. They decided that, in principle, access to international courts should be denied to all – see Chapter 2.02. They also decided that the law of the State they represented (or they themselves) should determine the meaning of undefined tax treaty terms – except, possibly, when this meaning was clear from its tax treaty context. Hoping to achieve these results, they began to adopt provisions comparable to Article 3(2) of the 1992 OECD Model.

As a result, “international tax language” has developed more slowly than would have been the case had tax treaties not contained provisions comparable to this Article 3(2) – and had international or supranational courts been charged with interpreting tax treaties, when they would probably have given the international tax language therein an autonomous contextual meaning (see Chapters 1 and 5).

The US was the first country to enunciate, in 1940, a principle comparable to that contained in Article 3(2).

The US (unilateral) Regulations (T.D. 4975, 1940-2 C.B. 43, 52) to the 1939 Sweden tax treaty ran in part: “Definitions – Any word or term used in these regulations which is defined in the convention shall be given the definition assigned to such word or term in such convention. Any word or term used in these regulations which is not defined in the Convention but is defined in the Internal Revenue Code shall be given the

definition defined therein.”

These Regulations were issued pursuant to Article XXI of the treaty – which authorised the contracting States to “prescribe regulations necessary to interpret and carry out the provisions of this convention”.

US IRC definitions were thus to govern any and all undefined terms – whether or not “the context otherwise requires”. This unilateral approach, whereby US tax law is to govern (at least in the US) the meaning of undefined tax treaty terms, may be inconsistent with a cardinal principle of (tax) treaty interpretation – that bilateral (tax) treaty terms should be interpreted in accordance with the understanding of *both* treaty partner States (see Chapter 5). If Sweden had agreed to this approach, it evidences two States agreeing, as they may, that unilateral domestic definitions should govern bilateral tax treaty terms. However, if Sweden had not agreed to this unilateral approach (which was only made public a year after the tax treaty was concluded) it amounts to one State seeking to impose its unilateral definitions on a (supposedly) bilateral treaty which had already been signed; arguably, it exhibits a desire to retain (or subsequently impose) fiscal sovereignty reminiscent of George III.

A tax treaty provision comparable to Article 3(2) first appeared in 1945 – in Article III(2) of the US income tax treaty with the UK.

Article III(2) ran: “2. As regards the application of this Convention by a Contracting State any term not otherwise defined shall, unless the context otherwise requires and subject to the provisions of Article 25 (Mutual Agreement Procedure), have the meaning which it has under the laws of that Contracting State relating to the taxes which are the subject of this Convention.”

Article III(2) includes the tempering words “unless the context otherwise requires”. These words were probably included at the instigation of the UK for two reasons. Firstly, as Avery Jones *et al.* have researched (1984, 93 Footnote 16), such words “were in almost universal use in UK Statutes from about 1890.” Secondly, the UK always includes these words in its tax treaties.

However, perhaps to compensate for the fact that domestic definitions are not to apply where the treaty context otherwise requires, Article III(2) provides that any definition mutually agreed to by the competent authorities is to govern. This provision was probably included at the instigation of the US – because it was also included in Article 3(2) of the 1981 US Model (see Chapters 7.04 and 27.05). This provision, supposedly endowing competent authorities with a power to define treaty terms, raises constitutional issues. It may be inconsistent with the most fundamental principle in countries with a democratic system of government (such as the UK and the US) – that tax can only be levied with the express authority of Parliament or Congress.

Provisions comparable to Article 3(2) began to proliferate after 1945, especially in tax treaties concluded by common law States.

Article 3(2) first appeared in a (Draft) Model in 1963.

Article 3(2) of the 1963 OECD Draft ran: “As regards the application of the Convention by a Contracting State any term not otherwise defined shall, unless the

context otherwise requires, have the meaning which it has under the laws of that Contracting State relating to the taxes which are the subject of the Convention.”

Para. 8 of the Commentary on Article 3(2) of the 1963 OECD Draft began: “The rule of interpretation laid down in paragraph 2 corresponds to similar provisions normally appearing in double taxation Conventions.”

By commenting that Article 3(2) “corresponds to similar provisions normally appearing in double taxation Conventions”, Para. 8 implies that it had become a “rule” of interpretation simply as a result of “appearing” in tax treaties – rather than as a result of any fundamental analysis (of which there is no evidence). This is consistent with its shortcomings.

The English text of Article 3(2) of the 1977 and 1992 OECD Models is virtually identical to Article 3(2) of the 1963 OECD Draft. The one change is that the 1963 Draft refers to “any term not otherwise defined”, whilst the 1977 and 1992 Models refer to “any term not defined therein”. Greater changes were made in the French text. The French text of the 1963 OECD Draft refers to the “*législation ... régissant*” (“statute ... governing”); the 1977 and 1992 OECD Models use the words “*droit ... concernant*” (“law ... relating to”). The 1977 and 1992 OECD Commentaries do not indicate that this change in the French text denotes any change in meaning; indeed, this change only seems to make the French words correspond more closely to the unchanged English words.

Less welcome were the 1977 changes to the Commentary. Para. 8 of the Commentary on Article 3(2) of the 1977 OECD Model simply runs: “This paragraph provides a general rule of interpretation in respect of terms used in the Convention but not defined therein.” Shorter than Article 3(2)’s text, Para. 8 is so succinct as to be misleading. It omits any reference as to why Article 3(2) came to be included in 1977 OECD Model in the first place. In an even less welcome development, and without any explanation, it also elevates its status to that of “a general rule of interpretation”.

Para. 8 could have begun more felicitously: “Paragraph 2 has often been included in tax conventions.” It could then have elaborated on the many different and fundamental issues raised by Article 3 – which were largely ignored until the Commentary on the 1992 OECD Model attempted to address them.

The 1992 OECD Model leaves the text of Article 3(2) unchanged – in line with the OECD’s acknowledged desire not to change any Articles unless this is essential. However, no doubt in view of the debates which have raged over the scope and meaning of Article 3(2), it includes new Commentary (Paras. 11-13) which was largely foreshadowed by Lüthi (1989).

Para. 11 begins by repeating what was Para. 8 of the 1977 Commentary: “This paragraph provides a general rule of interpretation in respect of terms used in the Convention but not defined therein.”

Para. 11 then continues: “11. ... However, the question arises as to which legislation must be referred to in order to determine the meaning of terms not defined in the Convention, the choice being between the legislation in force when the Convention was

signed or, on the contrary, that in force when the Convention is being applied, i.e. when the tax is imposed. The Committee on Fiscal Affairs concluded that the latter interpretation should prevail.

12. However, paragraph 2 specifies that this applies only if the context does not require an alternative interpretation. The context is constituted in particular by the intention [*sic*] of the Contracting States when signing the Convention as well as the meaning given to the term in question in the legislation of the other Contracting State (an implicit reference to the principle of reciprocity on which the Convention is based). The wording of the Article therefore allows the competent authorities some leeway.

13. Consequently, the drafting of paragraph 2 provides a satisfactory balance between, on the one hand, the need to ensure permanency of commitments undertaken by States when signing a convention (since a State should not be allowed to empty a convention of some of its substance by amending afterwards in its domestic law the scope of terms not defined in the Convention) and, on the other hand, the need to be able to apply the Convention in a convenient and practical way over time (the need to refer to outdated notions should be avoided)."

These Paras. are somewhat weak – despite their fifteen year gestation period.

Para. 11's last sentence is particularly feeble: not a single reason is given for the "conclusion" (foreshadowed by Lüthi – 1989, 9) that current domestic definitions should prevail. Indeed, this "conclusion" is immediately qualified by Para. 12 stressing that current domestic definitions should only prevail "if the context does not require an alternative interpretation." It would be far more appropriate for the order of these Paras. to be reversed, with the primary emphasis being on a tax treaty's context – see Chapter 7, notably Chapter 7.14.

The 1989 OECD *Override* Report (see Chapter 23.10 and Appendix I) had already concluded that, unless this was incompatible with the context of the tax treaty, current (and not original) domestic law should be referred to.

Para. 4 of this *Override* Report runs in part (*italics added*): "b) A State may change the definition of a term used in its domestic legislation which is also used in treaty provisions but which is not specifically defined for the purposes of the treaty. In this case there is no override where the treaty contains a provision essentially similar to that embodied in Article 3, paragraph 2, of the 1977 OECD Model ... which provides that, as regards the application of a treaty by a Contracting State, any term not defined in the treaty shall, unless the context otherwise requires, have the meaning which it has under the law of that State concerning the taxes to which the treaty applies. It cannot have been contemplated that, having once entered into a treaty, a State would be unable to change the definitions of terms used in its domestic law *provided such changes were compatible with the context of the treaty; ...*"

The second sentence of the above quotation from Para. 4 comments that, if a treaty contains a provision comparable to Article 3(2), a change in the domestic definition of term which is not defined in the treaty does not amount to an override. Read alone, this comment is over-simplistic – because it is obvious that a change in the domestic

definition of a term which is not defined in a treaty can amount to an override. It will amount to an override if it is outside the scope of Article 3(2) – i.e. if the context of the tax treaty otherwise requires.

The italicised proviso at the end of the above quotation makes this point in somewhat different terms. It provides that changed laws must be “compatible with the context of the treaty” if they are not to amount to an override.

An example of override is given in Case 2 of this *Override* Report. If a State enacts legislation deeming a sale of shares in a company owning immovable property be a sale of the immovable property itself, this amounts to an override of the tax treaty. It is explicit in Case 2 that, in the absence of such legislation, the tax treaty would preclude this State from taxing profits on the sale of such shares, but would not preclude it from taxing profits on the sale of immovable property.

As indicated above, the “context” of the tax treaty is thus all-important in deciding whether a changed domestic definition should apply – and Para. 12’s second sentence defines “context”. It begins by holding that “the context” includes (italics added): “the intention [*sic*] of the Contracting States *when signing* the Convention”. This (first) holding is wholly consistent with my view, expressed in Chapter 9.01, that the starting point of interpretation must be a tax treaty’s original meaning.

By stressing that the requisite intention [*sic*] is that of the Contracting States, Para. 12’s first holding is, again, wholly consistent with my view that the meaning of any tax treaty terms must reflect the common intention of *both* Contracting States – see Chapter 5. This view is confirmed by the remainder of Para. 12’s second sentence which holds, secondly, that “the context” also includes (italics added): “... the meaning given to the term in question in the legislation of the *other* Contracting State”. Expressing the word “intention” in the singular, rather than the plural, may also be a deliberate (albeit unclear) attempt to indicate that a sole intention, shared by both Contracting States, must be applied – see Chapter 5.01.

Para. 12’s second holding is, according to the end of Para. 12, “an implicit reference to the principle of reciprocity on which the Convention is based”. Despite being of such basic importance, this “principle” of reciprocity remains unexplained in the 1992 OECD Model; it is discussed in Chapter 12.

Para. 12’s last sentence runs: “The wording of the Article therefore allows the competent authorities some leeway.” It is unclear why Article 3(2) allows *competent authorities* any leeway, especially as Article 3(2) of the 1992 OECD Model does *not* include the words in Article 3(2) of the 1981 US Model which provide that it is subject to the provisions of Article 25 (Mutual Agreement Procedure) – see Chapters 7.04 and 27.05.

However, it is possible that Para. 12’s last sentence simply means that some leeway in a departure from an original meaning is permissible – because the meaning of tax treaty terms may evolve (see Chapter 9).

Para. 13 confirms the “permanency of commitments undertaken by States when signing a Convention” and that “a State should not be allowed to empty a convention

of some of its substance by amending afterwards in its domestic law the scope of terms not defined in the Convention". This holding is also wholly consistent with my view, (expressed in Chapter 9.11, above and below) that Article 3(2) could not have been intended to permit the override of a treaty by domestic law. As Langbein comments (1985, 153) as regards Article 3(2): "Later amendments to domestic law are therefore left out of consideration if they deviate from the intent and understanding of both contracting parties which have been embodied in the agreement."

The "substance" of a bilateral tax treaty cannot, therefore, be altered by changes in one State's domestic laws – because the context otherwise requires. As regards these qualifying words "unless the context otherwise requires" Ward comments (1983, 609): "This qualification might constitute an important limitation on the power of one of the contracting States to alter radically the application of its treaties by amending the definitions in its internal law, even if Article 3(2) is to have ambulatory effect."

Sir Ian Sinclair pointed out at the 1985 IFA Congress (Avery Jones 1986, 85) that an ambulatory approach "must be subject to inherent limitations. Some of these limitations, I would suggest, flow from the fact that Article 3(2) itself is a treaty text. It is not to be assumed that the application of Article 3(2) would or could lead to a result which would defeat the object and purposes of a treaty itself. A major change in internal law could have this effect and should therefore not be taken into account. It may be that this case would be regarded as falling within the orbit of the "unless the context otherwise requires" as has been suggested [notably by Ward]. But I would have thought that a major change in internal law which was either incompatible with the object and purpose of the treaty or involved an upsetting of the balance achieved by the treaty could in any event be ignored on the broader ground as indeed Article 27 of the Vienna Convention on the Law of Treaties provides, that a State is not entitled to involve a provision of its internal law as justification for its failure to perform a treaty." Article 27, and this broader ground, are discussed in Chapter 5.01.

The validity of the above comments are illustrated by the following (broadly chronological) analysis of the leading decisions and rulings on Article 3(2).

10.02 UK: July 16 1959 *Ostime* (Article 7)

In *Ostime* the Revenue argued in the House of Lords that the 1946 Australia tax treaty should be given its original meaning on October 29 1946 (the date of signature of the treaty) and not on April 23 1947 (when this treaty was given statutory effect in the UK). Accordingly, this original meaning was to be determined without reference to a March 1947 House of Lords judgment which changed what had hitherto been the accepted interpretation of the law.

Lord Radcliffe, noting (38 T.C. 519) that this argument "was presented to but not pressed upon us by the Crown", commented (38 T.C. 520): "I do not accept that it would make any ultimate difference even if the earlier view were treated as the only relevant one, but perhaps it is sufficient to say that I do not think that such a method of construction as is proposed ought to be applied to a bipartite taxation treaty of this

nature. All that can be said in such an Agreement is said by Article II(3) [a provision comparable to Article 3(2) of the 1977 and 1992 OECD Models], and that is not sufficient to assist the Crown's case."

Lord Radcliffe's comment indicates no more than that a provision comparable to Article 3(2) may not preclude the application of current domestic law – unless the context otherwise requires. This is no different from the situation where a tax treaty does not contain such a provision.

10.03 *Australia: September 20 1977 Sherritt Gordon (Article 12)*

In *Sherritt Gordon* fees were paid by a resident of Australia to a resident of Canada which had no permanent establishment in Australia. Under the 1957 Canada tax treaty, industrial or commercial profits derived by a resident of Canada with no permanent establishment in Australia were exempt from Australian tax. This treaty precluded "royalties" from being industrial or commercial profits – but it did not define "royalties". Article II(3) of the treaty (which was comparable to Article 3(2) of the 1977 OECD Model) therefore required "royalties" to be defined under Australian domestic law – unless the context otherwise required.

It was held that the fees were not royalties under Australian domestic law, either within their ordinary meaning, or within the statutory definition prevailing until 1968. Accordingly, the fees were exempt from Australian tax – at least until 1968.

In 1968, eleven years after the tax treaty was signed, the Australian statutory definition of royalties was expanded to include "any payment to the extent that the payment falls within the definition of "royalties" in paragraph (5) of Article 10 of the Agreement [the 1967 Australia/UK tax treaty]".

At issue was whether this expanded 1968 definition should apply to the fees in question. If so, these fees (which the 1957 Canada treaty had hitherto exempted from Australian tax because they were industrial or commercial profits – and not "royalties") would lose their former treaty exemption.

In the Victorian Supreme Court, McInerney J. held that the 1968 statute was inconsistent with the treaty. Despite the existence of Article II(3) – and hence a mandatory reference to domestic law – this change in domestic law some years after the treaty was concluded should not apply. However, McInerney J.'s decision was not based on Article II(3) – but on s.2(2) of the Income Tax (International Agreements) Act, which provides that a tax treaty shall have effect notwithstanding anything inconsistent with its provisions contained in the Income Tax Assessment Act (other than s.160AO of that Act). Accordingly, in the absence of an express intention to override the treaty, the expanded domestic definition was not to apply.

The Full High Court upheld McInerney J. – on different grounds – but also ducked the issue of whether Article II(3)'s reference to domestic law was static or ambulatory.

Mason J. (with whom Gibbs J. agreed) held that, even if this reference was ambulatory, the amendment did not cover a payment to a resident of Canada – because it only covered a payment which fell within Article 10(5) of the UK tax treaty (i.e. a

payment to a resident of the UK).

There was no need for Mason J. to make this questionable holding. He could have held (just as satisfactorily) that, pursuant to Article II(3)'s very terms, *the context* of the treaty required that the expanded domestic definition should not apply – because it was inconsistent with the meaning of the term “royalty” in the tax treaty.

Mason J. could easily have held to this effect – because he reached a comparable conclusion without referring to Article II(3). He held (77 ATC 4,370): “It is quite appropriate that the Assessment Act should be amended so as to effect an alteration in the law consequential upon the introduction of the new UK agreement, so long as the alteration in the law is confined to the scope and sphere of operation of that agreement. It is quite inappropriate that the Assessment Act should be amended so as to have a much wider application to taxpayers whose affairs are dealt with by other international agreements, in particular the Canadian agreement which contains no provision corresponding to art. 10(5). Indeed, the very occasion for the inclusion of the statutory definition by Act No. 4 of 1968 strongly suggests that it was designed only to give effect to the new UK agreement and that its purpose was not to affect the liability of taxpayers whose affairs were governed by other double taxation agreements to which Australia was a party.”

Sherritt Gordon was effectively acquiesced to fourteen years later, when Australia: November 28 1991 IT 2660 (Article 12) defined the term “royalty” for the purposes of Australian domestic law. IT 2660 provides in part: “6. Where there is a conflict between the definition of royalties for purposes of Australia’s domestic tax law and that in a particular double tax agreement, the definition in the relevant double tax agreement will override subsection 6(1) of the Assessment Act (subsection 3(9), Income Tax (International Agreements) Act).”

10.04 *Several US rulings incorrectly cite Article 3(2)*

When a tax treaty permits a State’s domestic law to operate to avoid double taxation (or, because this treaty has allocated to this State the right to tax, to impose tax), this law can operate, and change, without constraints (other than discriminatory constraints) – see Chapters 9.08 and 9.10. This freedom of operation is wholly independent of Article 3(2).

For example, when a State has been allocated a right to tax it can choose whether, and how, to tax. Within the limits of its treaty-given taxing rights (i.e. the context of a tax treaty) it is free, at any time, to change such tax as it may hitherto have imposed – or to impose tax in situations where, formerly, it has not imposed tax. To repeat: this freedom of operation is wholly independent of Article 3(2) – it derives from the obligations imposed, or rights given, by the tax treaty as a whole.

By incorrectly citing provisions comparable to Article 3(2) of the 1977 OECD Model, and by failing to stress that they only apply when the context does not otherwise require, several US rulings imply that they allow a State’s domestic law to apply without limitation – even to the extent of allowing a State to unilaterally expand

its right to tax. Any such implication is misleading.

The background to these US rulings is as follows. At the time the 1945 US/UK tax treaty was concluded, the US allowed US permanent establishments to deduct from their US profits an amount of UK tax on these profits which arose because UK corporate tax rates were higher than US corporate tax rates. An example of this deduction is given in US: Rev. Rul. 55-532 (Article 23).

The 1945 UK/US tax treaty did not mention whether permanent establishments were entitled to make any deductions in computing their local profits – let alone a deduction of the kind described in the preceding paragraph. Article III(3) simply provided that there shall be attributed to a permanent establishment “the industrial or commercial profits which it might be expected to derive if it were an independent enterprise ...”

10.05 US: LR 78-44-008 (Article 7)

US: LR 78-44-008 notes that this 1945 UK treaty contained a provision (Article II(3) – see Chapter 10.01) comparable to Article 3(2) of the 1977 OECD Model. It also notes that prior to its amendment in 1966 (see below), Article III was silent as to whether any expenses were allowable as deductions. LR 78-44-008 then holds (*italics added*): “Thus, *pursuant to Article II(3) of the Treaty*, it was necessary to refer to the internal laws of the appropriate Contracting Party to determine whether any expenses attributable to a permanent establishment situated in such Contracting Party are allowable as deductions.”

LR 78-44-008 implies that Article II(3) makes the internal laws of the State which has the right to tax a permanent establishment’s profits determinative is to what expenses should be allowable as deductions – presumably because these laws are to define these “profits”. This implication is misleading. Article III(3) determines what profits a State may tax. A State can then choose the extent to which it will exercise such rights to tax as Article III gives it. Once a tax treaty has given a State an unrestricted right to tax a local permanent establishment’s profits, this State may tax these profits as it pleases. This right is wholly independent of a provision comparable to Article 3(2) of the 1977 OECD Model (such as Article II(3) of this 1945 UK tax treaty). LR 78-44-008’s irrelevant and incomplete citation of Article II(3) implies that it permits the application of any US domestic laws – even if they increase the ability of the US to impose tax. However, the extent to which these changed domestic definitions can apply must always be subject to the context of a tax treaty.

Article III(3) of the 1945 UK tax treaty gives the US the right to tax the industrial or commercial profits which a local permanent establishment “might be expected to derive if its were an independent enterprise”. This is the (treaty) criterion for determining what profits the US may tax – and hence what deductions should be allowed in calculating these profits. It is then necessary to refer to US internal law to determine the extent to which the US has chosen to exercise its right to tax. However, US internal law is referred to because Article III has already given the US the right to tax the profits in question – and not “pursuant to” Article II(3).

Once (pre-1966) US internal law is referred to, it becomes apparent that, by allowing the deduction for UK tax referred to above, the US was choosing not to exercise in full its right to tax the profits in question.

On March 17 1966 this 1945 UK tax treaty was amended to provide, in terms similar to Article 7(3) of the 1977 and 1992 OECD Models, that in determining the industrial or commercial profits of a permanent establishment there shall be allowed as “deductions” all expenses “reasonably connected” with such profits.

LA 78-44-008 also notes that this 1966 treaty amendment “does not define what types of expenses shall be allowed as deductions, nor does it define “reasonably connected”. Thus, it is once again necessary to look to the internal laws of the appropriate Contracting Party to answer such questions.” Once again, LR 78-44-008 incorrectly implies that *Article II(3)* permits *any* internal laws to determine what expenses may be allowed as deductions in a tax treaty context.

After this 1966 treaty amendment, but also in 1966, the Foreign Investors Tax Act (FITA) abolished the deduction for UK taxes which US permanent establishments had previously benefited from. By so curtailing its aforementioned deduction for US tax, the US was simply choosing to exercise, to a greater extent than previously, its right to tax the profits in question. This proper exercise of existing US taxing rights did not amount to an improper override of the tax treaty.

LR 78-44-008 then referred to additional arguments, namely (*italics added*): “... that the internal law at the time of enactment of the Treaty controls, and therefore, the changes made by FITA subsequent to the signing of the last Protocol on March 17, 1966, should not be applied in construing terms of the Treaty. Based on the essentially contractual nature of a treaty, the fundamental question is whether the contracting parties intended that the treaty refer to internal law in effect at the time of ratification of the treaty or as subsequently amended.

It may be argued that since the contracting parties negotiated the Treaty in light of existing internal law, they intended that the terms of the Treaty be construed thereunder; and further, that subsequent amendment of internal law affords the unusual opportunity to one of the signatories to make a unilateral change that will have an impact on the provisions of a bilateral agreement. In fact, a few treaties have expressly limited the application of internal law to that in force on the date of signature. e.g., US-Honduras Income Tax Treaty, Article XX(6), now terminated. However, we believe that the better view is that, *absent a clear intent to limit the internal law to that in force at the time of a treaty's ratification, subsequent changes in internal laws should be given full effect.*

One must keep in mind that the purpose of a treaty is different from that of the Code. A treaty attempts to state certain broad principles upon which the contracting parties agree, necessarily leaving the particulars to be defined by the internal laws of each signatory. The Code, on the other hand, attempts to anticipate and deal with specific problems. The intent of the drafters in taking this approach, we believe, was to allow for a certain amount of “breathing room” in the internal law, even though a change

therein might have some impact upon a provision in a treaty. Based upon the fact that the US-UK Treaty and Protocol follow the general pattern of other US income tax treaties, we feel that this is sufficient evidence of the intent of the drafters of these documents that this “breathing” concept be used when it is necessary to refer to internal law for purposes of interpretation.

Although we cited the now defunct Honduran Treaty in the material above as an example of a treaty in which the parties expressly agreed to apply the internal law in force on the date of signature, even that provision clearly accepted the “breathing” concept. Article XX(6) of that Treaty provided as follows: “The present convention has been concluded with reference to US and Honduran law in force on the date of signature of the present Convention. If such laws are appreciably modified, the competent authorities of the two contracting States will consult together.”

Although it is not necessary here to pass upon whether this provision is, in effect, a recitation of the concept we have espoused above, had the parties not both clearly recognized that later changes in internal law could have an impact on the Treaty provisions, the second sentence of the provision set forth above would have been entirely unnecessary.

Further support for our view may be found within the four corners of the US-UK Protocol. Article XXI(2) provides, in part: “A permanent establishment which an enterprise of one of the Contracting Parties has in the other Contracting Party shall not be subject in that other Contracting Party to more burdensome taxes than is an enterprise of that other Contracting Party carrying on the same activities.”

We believe that this “nondiscrimination” clause in addition to assuring that the internal laws in force at the time the Protocol was signed would not be applied in a discriminatory fashion was also intended to guarantee that no law would be created in the future that would have such a result.”

The above passages in LR 78-44-008 can be criticised – which may be why they were not included in the later US: Rev. Rul. 80-243 (Article 7 and see Chapter 10.06).

LR 78-44-008’s most debatable holding is contained in the words italicised above: “... absent a clear intent to limit the internal law to that in force at the time of a treaty’s ratification, subsequent changes in internal laws should be given full effect.”

This holding incorrectly implies that *any* changes in internal laws should be given *full effect*. However, the correct view is that whilst a State may change its internal laws within the parameters of such rights to tax as a tax treaty may have given it, any changed internal laws which seek to unilaterally expand its rights to tax will amount to an attempt to override the tax treaty. In other words, once a tax treaty has given a State rights to tax, it may exercise these rights to the extent it pleases and full effect should be given to any changes it makes in exercising these rights – whether it chooses to exercise them to a greater or to a lesser extent. However, any change in domestic law which seeks to expand or increase a State’s rights to tax will amount to an override of a tax treaty – and a breach of this State’s international obligations.

In Canada: February 19 1992 *Utah Mines* (Article 7 and see Chapter 9.17) Walsh J.

spotted that LR 78-44-008's holding that "subsequent changes in internal laws should be given full effect" was far too broad.

In contrast to LR 78-44-008, Walsh D.J. appreciated that this debatable holding was weakened, rather than strengthened, by a commitment to consult comparable to the last sentence of Article XX(6) of the US/Honduras tax treaty referred to in LR 78-44-008, such as Paragraph 2 of the Protocol to the 1942 US tax treaty at issue in *Utah Mines*.

This Paragraph 2 provided (italics added): "In the event of *appreciable changes* in the fiscal laws of either of the contracting States, the governments of the two contracting States will consult together."

Walsh D.J. commented (91 DTC 5249): "Section 18(1)(m) of the *Income Tax Act* might well be considered as an "appreciable change"."

A commitment to notify is also contained in the second sentence of Article 2(4) of the 1977 and 1992 OECD Models. This sentence runs: "At the end of each year, the competent authorities of the Contracting States shall notify each other of changes which have been made in their respective taxation laws." Para. 7 of the 1977 and 1992 OECD Commentary notes (italics added) that this sentence: "... is necessary to prevent the Convention from *becoming inoperative* in the event of one of the States modifying its taxation laws."

The implications of Para. 7's italicised words are clear: changes in a State's taxation laws may lead to a tax treaty becoming inoperative if they change the basis (such as the allocation of taxing rights) on which the tax treaty had originally been negotiated. This is why a commitment to consult or to notify weakens the argument that *all* subsequent changes in domestic laws should be given full effect in a tax treaty context.

Such a commitment does clearly recognise that, as LR 78-44-008 notes, "later changes in internal law could have an impact on the Treaty provisions". However, this recognition does not amount to an acceptance that such changes should be given effect in a tax treaty context. Quite the contrary. This recognition acknowledges that if such changes affect any part of the substance of a tax treaty, they affect the very basis upon which it had originally been negotiated – and will amount to an attempted override.

Article 25(3) of the 1977 and 1992 OECD Models provides support for this view.

Article 25 runs in part: "The competent authorities of the Contracting State shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention."

In relation to Article 25(3), Para. 31 of the 1977 OECD Commentary (and Para. 34 of the 1992 OECD Commentary) note (italics added): "Under this provision the competent authorities can, in particular ... :

– where the laws of a State have been changed *without impairing the balance or affecting the substance* of the Convention, settle any difficulties that may emerge from the new system of taxation arising out of such changes."

These Paras. accordingly recognise that if any changes in a State's domestic laws do go so far as "impairing the balance or affecting the substance" of a tax treaty, they will be inconsistent with this treaty and will amount to an attempted override.

10.06 US Rev. Rul. 80-243 (Article 7)

Rev. Rul. 80-243 is very comparable to LR 78-44-008 and also involves the 1945 (Old) and 1980 (New) UK treaties. It runs in part (*italics added*): “Under Article III(3) of the Old Convention, as modified by the Old Supplementary Protocol, in determining the industrial and commercial profits of a US permanent establishment, deductions are allowed for all expenses that would be deductible if the permanent establishment were an independent enterprise, if they are reasonably connected with the taxable profits, wherever the expenses are incurred. Under Article 7(3) of the New Convention, in determining the profits of a US permanent establishment, deductions are allowed for those expenses which are incurred for the purposes of the permanent establishment, wherever those expenses are incurred. Neither Article III(3) of the Old Convention nor Article 7(3) of the New Convention elaborates on what income tax expenses are allowed as deductions.

Article II(3) of the Old Convention and Article 3(2) of the New Convention provide that, with respect to the application of the respective Conventions by one of the Contracting Parties, any term not otherwise defined shall, unless the context otherwise requires, and subject to Article 25 (Mutual Agreement Procedure), have the meaning which it has under the laws of that Contracting Party relating to the taxes which are the subject of the Convention. Since neither Article II(3) of the Old Convention nor Article 3(2) of the New Convention elaborate on what income tax expenses are allowed as deductions, *the context of those Articles* does not otherwise require, and there has been no mutual agreement under Article 25(3), reference is made to US internal law in accordance with Article II(3) of the Old Convention and Article 3(2) of the New Convention to determine what tax expenses are allowed as deductions.”

Chapter 7.05 has already described why it is inaccurate for Rev. Rul. 80-243 to hold that the relevant “context” of a tax treaty provision such as Article 3(2) of the 1977 OECD Model is the context of this provision alone.

Rev. Rul. 80-243 continues (*italics added*): “Under the Code in effect at the time the Old Convention was signed, and subsequently at the time the Old Supplementary Protocol was signed and became effective, a deduction was allowed by US internal tax law for a ratable portion of the UK income taxes paid by UK corporations in computing taxable income from sources within the US. ... However, section 906(b)(1)(B) of the Code, added by the Foreign Investors Tax Act of 1966, Pub. L. 89-809, 1966-2 C.B. 656 (FITA), has the effect of denying this deduction unless the application of section 906(1)(B) would be contrary to an existing treaty obligation, in which case section 110 of FITA provides that section 906(b)(1)(B) shall not apply.

The Old Convention as it is currently constituted does not contain a provision requiring that an interpretation be made with reference to internal law in effect on a particular date, although such references were included elsewhere in the Old Convention in the past. See, for example, Article XIII(1) of the Old Convention, prior to amendment by Article 9 of the Old Supplementary Protocol, which provided, with

respect to the foreign tax credit applicable to certain dividends and royalties, that the credit would be allowed “[s]ubject to sections 901 to 905 of the US Internal Revenue Code as in effect on the 1st day of January 1956.” Therefore, in determining what income tax expenses are deductible by X for 1974 in computing its US income tax liability under the Code, section 906(b)(1)(B) must be applied even though it was not in the Code at the time the Old Convention and the Old Supplemental Protocol became effective.

Section 110 of FITA does not prevent the application of section 906(b)(1)(B) under the Old Convention. Article III(3), as previously indicated, does not elaborate on what income tax expenses are allowed as deductions and section 906(b)(1)(B) is therefore not contrary to the Old Convention. Similarly, the provisions of section 906(b)(1)(B) are not contrary to Article 7(3) of the New Convention, which also does not address what income tax expenses are deductible. Therefore, *pursuant to Articles II(3) and 3(2) of the Old and New Conventions*, respectively, section 906(b)(1)(B) [must be] applied and precludes X from taking a deduction on its 1974 and 1975 federal income tax returns for foreign taxes that are paid with respect to income from sources within the US that would not be taxed by the UK but for the fact that X is domiciled for tax purposes in the UK.”

In common with LR 78-44-008, Rev. Rul. 80-243 holds that an amendment to domestic law by FITA could deny a UK corporation the aforementioned deduction for UK tax paid in respect of the profits of its US branch – even though this deduction had been available when the treaty had originally been concluded. This holding is correct – albeit not because of a provision comparable to Article 3(2) of the 1977 OECD Model, but because this amendment simply amounts to the US choosing to exercise its treaty-allocated right to tax to a greater extent.

However, also in common with LR 78-44-008, Rev. Rul. 80-243 incorrectly invokes provisions comparable to Article 3(2) as justifying an increase in US taxes. As indicated above, other Articles in the treaty had already given the US the right to tax the income in question – and this right cannot be increased by provisions comparable to Article 3(2), which Rev. Rul. 80-243 should not have cited. Rev. Rul. 80-243 should simply have focused on its key holding that the tax increase brought about by the enactment of section 906(b)(1)(B) of the Code is not contrary to either the 1945 or the 1980 UK tax treaties. This unilaterally changed result did *not* amount to an override. Indeed, an override was expressly prohibited by the very Act (FITA) which introduced the amendment bringing about this changed result.

10.07 US: Rev. Rul 78-423 and Rev. Rul. 85-7 (both Article 7)

US: Rev. Rul. 78-423 and Rev. Rul. 85-7 are two other examples of the US tax authorities incorrectly invoking a provision comparable to Article 3(2) of the 1977 OECD Model, namely Article 2(2) of the 1971 Japan tax treaty. They hold that this provision permits (changing) US domestic law to determine the extent to which the US will exercise its right to tax.

Rev. Rul. 78-423 holds that the allocation and apportionment of a foreign bank's worldwide interest expense to a US permanent establishment are to be determined under section 1.861-8 of the regulations – *because* this treaty does not provide a specific rule determining the allocation of expenses “reasonably connected” with the profits of a US permanent establishment. Rev. Rul. 78-423 incorrectly holds (italics added): “*Thus, in the absence of such a rule, Article 2(2) of the Convention indicates that the general domestic law of the US is to be applied for the purpose of determining the expenses “reasonably connected” with the profits of a US permanent establishment.*” As explained above, Article 2(2) does not indicate anything of the sort.

In a clear example of changed domestic law being held to apply, Rev. Rul. 78-423 holds that section 1.861-8 of the regulations, which only became effective for tax years beginning in 1977, was to apply to the Japan tax treaty which had been concluded six years earlier – in 1971.

In an even clearer example of changed domestic law being held to apply, Rev. Rul. 85-7 (Article 7) holds that a modification to section 1.861-8 of the regulations rendered Rev. Rul. 78-423 obsolete.

Rev. Rul. 85-7 runs in part: “Subsequent to the publication of Rev. Rul. 78-423, regulations applicable to foreign corporations were issued under section 882(c) of the Code. For periods to which it applies, section 1.882-5 of the regulations is the general domestic law of the US to be applied in determining the interest expenses that are “reasonably connected” with the profits of a US permanent establishment. Therefore, section 1.882-5, rather than section 1.861-8, applies to determine the interest expenses that are “reasonably connected” with the profits of a US permanent establishment.”

Because Article 8(3) of the 1971 Japan treaty did not define which expenses were “reasonably connected” with a permanent establishment, Rev. Rul. 85-7 holds that the most current US domestic regulations should apply to determine such expenses. Again, Rev. Rul. 85-7 incorrectly invokes Article 2(2) of this treaty as support for its holding.

A further illustration of the inapplicability of Article 2(2) is that *any* (US) domestic regulations mandating an allocation and apportionment of expenses may be inconsistent with this 1971 Japan tax treaty and with the 1977 and 1992 OECD Models – all of which define a permanent establishment's profits as being those “attributable to” it.

Thus, Article 8 of this 1971 Japan tax treaty limits a permanent establishment's profits as being those “attributable to” it – with any expenses “reasonably connected” with such profits qualifying as deductions.

Similarly, Article 7 of the 1977 and 1992 OECD Models defines a permanent establishment's profits as being those “attributable to” it – with any expenses “incurred for [its] purposes” qualifying as deductions.

The aforementioned US regulations should not be applied to the extent that they are inconsistent with any such “attributable to” definitions governing the allocation of the right to tax – in the absence of legislative evidence that these definitions are meant to be overridden.

No such inconsistency may arise, however, under the 1981 US Model – Article 7(3) of which permits “a reasonable allocation” of expenses.

10.08 Canada: September 11 1982 Melford (Article 7)

In *Melford* a Canadian corporation paid guarantee fees to a German bank. It was agreed that if these guarantee fees were “industrial and commercial profits” (covered by Article III of the 1956 Germany tax treaty) they would be exempt from Canadian tax – because the German bank had no permanent establishment in Canada. However, Article III(5) excluded “interest” from its definition of industrial and commercial profits. Article II(2), which was comparable to Article 3(2) of the 1977 OECD Model, required “interest” to be defined according to (Canadian) domestic law – unless the context otherwise required.

When this 1956 Germany treaty was negotiated, a guarantee fee was not interest under Canadian domestic law. At this time, therefore, a guarantee fee was an industrial or commercial profit. However in 1974 (eighteen years later) the Canadian Income Tax Act was amended to deem the payment of a guarantee fee to be a payment of interest. At issue was whether a guarantee fee paid after this 1974 amendment came into force could continue to benefit from the tax treaty exemption which had hitherto been available.

In the Federal Court of Appeal Urie J. rejected the argument that a provision comparable to Article 3(2) of the 1977 OECD Model entitled Canada to override a tax treaty. He commented (81 DTC 5024): “... what is referred to in Article II(2) of the Convention as the meaning of terms is the meaning of the terms in the statutes in force when the Convention was negotiated. That accords with what is generally recognized as the rule that is used in determining the meaning of words or terminology embodied in an agreement (and the Convention here in issue is essentially an agreement between the contracting states) which is that such words or terminology ought to be given the meaning ordinarily ascribed to them in the contracting states at the time the agreement was entered into. I find it difficult to believe that it could have been intended that some years after the negotiation of the Convention one of the parties could, without further negotiation or discussion or without entering into an amendment to the Convention, enlarge, restrict or otherwise vary the meaning of the words or terminology as accepted by the parties from the taxing statutes as they existed at the time of the negotiation and execution of the Convention. That is, in effect, what the Appellant urges us to do by enlarging the meaning of interest as it was and is ordinarily understood, through the application of subsection 214(15) of the Act, enacted eighteen years after the Convention, and so reading it in conjunction with paragraph 5 of Article III of the Convention. I do not think that we ought to accept that submission.”

In the Supreme Court Estey J. took a comparable stance. In relation to Article II(2) he held (82 DTC 6285): “Laws enacted by Canada to redefine taxation procedures and mechanisms with reference to income not subjected to taxation by the agreement are not, in my view, incorporated in the expression “laws in force” in Canada as employed

by the agreement. To read this section otherwise would be to feed the argument of the appellant, which in my view is without foundation in law, that subs.(2) [*Editorial: Article II(2), the provision comparable to Article 3(2) of the 1977 OECD Model*] authorizes Canada or Germany to unilaterally amend the tax Treaty from time to time as their domestic needs may dictate.

It is well to remind ourselves in analysing these statutes and the subtended tax Agreement that the international Agreement does not itself levy taxes but simply authorizes the contracting parties, within the terms of the Agreement, to do so.”

Estey J. continued later (82 DTC 6285): “There is, of course, no room for debate on the proposition that Parliament is supreme and can neither bind itself nor any successor of Parliament when acting within its constitutionally assigned sovereign jurisdiction. Obviously it follows that section 3 or any other part of the 1956 statute can be repealed or amended. The question is not that, the question is whether the collateral legislative action in connection with the *Income Tax Act* has the effect of amending the 1956 statute. The suggestion that it does have such an effect is startling. There are twenty-six concluded and ten proposed conventions, treaties or agreements between Canada and other nations of the world. If the submission of the appellant is correct, these agreements are all put in peril by any legislative action taken by Parliament with reference to the revision of the *Income Tax Act*. For this practical reason one finds it difficult to conclude that Parliament has left its own handiwork of 1956 in such inadvertent jeopardy. That is not to say that before the 1956 Act can be amended in substance it must be done by Parliament in an Act entitled “An Act to Amend the Act of 1956.” But neither is the converse true, that is that every tax enactment, adopted for whatever purpose, might have the effect of amending one or more bilateral or multilateral tax conventions without any avowed purpose or intention so to do.

There is no doubt, in my view, that the effect of s.3 is to make the operation of any other law of Parliament, including the *Income Tax Act*, subject to the terms of the 1956 Act and the incorporated Agreement. The only exception to this result would be where Parliament has expressly set out to amend the 1956 statute. Then, of course, there is no conflict between the 1956 Act and “any other law”. ”

Unfortunately, these commendable views were then marred by Estey J. continuing (82 DTC 6285, italics added): “This interpretation has the *necessary result* of embodying in the Agreement, by reason of Act II(2), as definitions of the words not therein defined, the meaning of those words at the time the Agreement was adopted.”

This sentence confuses the two questions of whether Canada *can* override a tax treaty, and whether Canada *has* overridden a tax treaty – as well as the third question of whether the meaning of tax treaty words can evolve.

As regards the first question, Estey J. had already held that there is “no room for debate” on the proposition that Parliament *can* enact override legislation.

As regards the second question, Estey J. found the proposition that the legislation might have overridden the tax treaty to be “startling”.

As regards the third question (whether the original meaning of tax treaty terms can

evolve) Estey J. incorrectly held that it was a *necessary result* of his holding in relation to the first two questions that the tax treaty terms (which, pursuant to Article II(2), had to be defined by reference to domestic law unless the context otherwise required) had to retain, for evermore, the original meaning they had at the time when the tax treaty was concluded. However, his holding in relation to the first two questions does not, *as a necessary result*, answer this third question. A holding that a State has not overridden a tax treaty does not *necessarily* mean that its terms must always receive their original meaning – it only means that the legislation has not overridden it.

As regards this third question, Estey J. (and Urie J. in the Court of Appeal) should simply have held that Canada's amendment should not have applied because the tax treaty's context otherwise required. Thus, the Supreme Court reached the correct result – but on reasoning which could have been improved.

10.09 *The evolutionary approach to tax treaty interpretation applied to Melford*

If the evolutionary approach to tax treaty interpretation explained in Chapter 9.06 is applied to *Melford*, the first question is: *can* Canadian domestic legislation expressly override the treaty? Once this question has been answered in the affirmative, the second question is: *has* this legislation expressly overridden the treaty? Once this question has been answered in the negative, the third question is: what was the original meaning of the term “interest” at the time the treaty was originally concluded? *Melford* (correctly) found that this meaning did not include guarantee fees.

The fourth question which should then have been asked in *Melford* is: by the time the facts arose, had the original meaning of the term “interest” *generally* evolved for tax treaty purposes to include guarantee fees? The answer to this fourth question is that the word “interest” had not generally evolved for tax treaty purposes.

The fifth question which should then have been asked in *Melford* is: does a provision comparable to Article 3(2) of the 1977 OECD Model change the position – and enable a State to unilaterally change the meaning of tax treaty terms by changing its domestic legislation? The answer to this question is in the negative – except to the extent that it can be presumed that the parties originally intended that such changed domestic meanings should apply. This can only be the case if changed domestic meanings are compatible with their tax treaty context – i.e. if this context does not otherwise require. If these words are interpreted so as to stress the importance of a tax treaty's context, as suggested in Chapter 7.14, this will mean that a provision comparable to Article 3(2) cannot normally permit a State to override a tax treaty and expand such taxing rights as other treaty Articles give it.

Accordingly, although Canada's changed domestic law deemed interest to include guarantee fees, this unilateral definition could not be applied in the context of the 1956 Germany tax treaty – because it was not in accordance with the original understanding of *both* treaty partner States (i.e. with the context of the tax treaty).

10.10 *The evolutionary approach to tax treaty interpretation in Canada after Melford*

Unable to fire its judges, the Canadian Government's response to *Melford* was to attempt to override it by the Income Tax Conventions Interpretation Act.

s.3 of this Act provides that (*italics added*) *except to the extent that the context otherwise requires*, undefined terms in a treaty are to have the meaning that they have for the purposes of the Income Tax Act, as amended from time to time (and not the meaning they had at the time the treaty was entered into if its meaning for the purposes of the Income Tax Act has changed after that date).

Because s.3 includes the key words "unless the context otherwise requires" it is arguable that the only effect it may have in practice is to confirm what I regard to be already the case – namely that tax treaty terms are only capable of evolution to the extent that this reflects the original intention of both contracting States (i.e. the context).

Accordingly, despite this override legislation, Canadian courts can still adopt an "evolutionary" approach to tax treaty interpretation – and should do so. This approach involves interpreting the words "*except to the extent that the context otherwise requires*" in s.3 of the Income Tax Conventions Interpretation Act so as to stress a tax treaty's *context*. These italicised words will then be interpreted (as the Canadian Legislature may have intended) in exactly the same way as the virtually identical words in Article 3(2) of the 1977 and 1992 OECD Models. Because s.3 requires "the context" of a tax treaty to be considered, the original meaning of tax treaty terms remains just as relevant as it was before – because this original context can only be ascertained by considering this original meaning. As was the case formerly, a changed Canadian domestic definition will only override the meaning of a tax treaty term when this is consistent with both parties' original expectations (and the treaty's original context). This approach is no different to that which I have suggested (in Chapters 9.06 and 10.01) is the correct approach to the interpretation of Article 3(2).

Comparable considerations should also apply to those tax treaties which contain an "evolutionary" Article 3(2) – providing this "evolutionary" Article 3(2) also contains the key words "unless the context otherwise requires".

10.11 US: April 11 1983 Burghardt Estate (Article 3)

Burghardt, a German and not a US citizen, died in Italy. She was neither resident nor domiciled in the US. Her estate included assets in an account with Bankers Trust in New York. These assets were subject to US estate tax.

In 1955, the estates of US citizens could benefit from an *exemption* or *deduction* of \$60,000. Article IV(a) of the 1955 Italy estate tax treaty aimed to grant the benefit of this exemption or deduction to the estates of Italian residents. Accordingly, Article IV(a) provided that, in calculating US estate tax, the US had to grant Italian residents a "specific exemption" available to US citizens.

The phrase a "specific exemption" was not defined in the treaty. Therefore, according to its Article II(2) (which is comparable to Article 3(2) of the 1977 OECD Model), this term had to receive the meaning it had under US domestic law – unless the context

otherwise required.

The Tax Reform Act of 1976 then abolished the \$60,000 deduction. Instead, it gave the estate of a US citizen or resident a unified tax credit – and the estate of *any* nonresident alien (whether it benefited from a tax treaty or not) a \$3,600 tax credit.

The US tax authorities argued that the phrase “specific exemption” was a direct reference to the \$60,000 deduction applicable at the time the treaty was entered into. Because this deduction had been abolished, the Estate was not entitled to any treaty exemption – and was restricted to the \$3,600 tax credit allowable to any nonresident.

The Estate argued that the phrase “specific exemption” in the treaty was a general term which described the level at which estate tax began. It should therefore include the unified tax credit introduced by the Tax Reform Act of 1976.

Tannenwald C.J. considered the impact of Article II(2) – and accepted the Estate’s argument that the term “specific exemption” was not synonymous with the repealed \$60,000 deduction, but merely described the mechanism whereby small estates are excluded from the scope of US estate tax. He therefore held that although the phrase “specific exemption” initially encompassed a *deduction*, it should also encompass the unified tax *credit* which replaced this deduction. Quoting Gertrude Stein, he concluded (80 T.C. 718): “To respondent’s assertion that our interpretation mixes apples (the unified credit) and oranges (the specific exemption), we think the literary quote more appropriate to the issue involved herein is “Rose is a rose is a rose is a rose”.”

Tannenwald C.J. held (80 T.C. 708, italics added): “To decide this case, we must examine the following questions. First, does *the context* of article IV of the Italian treaty require that we define “specific exemption” in any particular way?”

Tannenwald C.J. then focused on the legislative histories of this treaty and comparable estate tax treaties with Australia, Finland, Greece, Japan, Norway and Switzerland, as well as the different 1944 Canada estate tax treaty.

He then held (80 T.C. 711, italics added): “In view of the foregoing, we are satisfied that *the context* of article IV of the treaty permits us to read “specific exemption” in the broad sense to mean the method by which small estates are exempted from the estate tax.”

Although Tannenwald C.J.’s focus on the context of Article IV is welcome, it is regrettable that he did not stress that, even if the term “specific exemption” was synonymous with the repealed \$60,000 deduction under US domestic law, the context of the tax treaty precluded the application of this definition.

This seems to be what Tannenwald C.J. really thought – because his judgment ends (80 T.C. 717 and 718): “The long and the short of this case is that the term “specific exemption,” as used in the Italian treaty, should be construed as including the unified credit. To hold otherwise, as respondent would have us do, would read the “specific exemption” provision out of the Italian treaty; such a result would have the effect of placing nonresident aliens of the US who are either nationals of, or domiciled in, Italy in the same category as any non-US national domiciled in a foreign country with which the US has no tax convention. Under these circumstances, one of the objectives of a tax

convention, namely, to obtain an advantage for certain nationals of the parties to the convention, would be lost. Indeed, it appears that the treaty provision involved herein was designed to eliminate the discrimination which would otherwise exist against estates of nonresident citizens of the treaty country and in favor of the estates of citizens or resident of the US. See the analysis of the Joint Comm. on Internal Revenue Taxation quoted on pp. 708-709 *supra*; R. Stephens, G. Maxfield & S. Lind, *Federal Estate and Gift Taxation* 7-17 (1978 ed.). If we were to sustain respondent's position, we would be reinstating such discriminatory treatment. Beyond this, a holding that unification, which was only intended to make the tax laws more equitable, abrogated certain provisions of the Italian treaty would violate the maxim that treaties are to be liberally construed (*Samann v. Commissioner* [US: January 16 1963 *Samann* – Article 25 and see Chapter 11], 36 T.C. at 1014-1015), the maxim that the intention to modify a treaty is not to be lightly imputed to Congress (see, e.g., *Menominee Tribe v. US*, 391 U.S. at 413), and the reasonable expectations of the parties. *Maximov v. US* [US: April 29 1963 *Maximov* – Article 4 and see Chapter 12.03], 299 F.2d at 568.”

Avery Jones *et al.* commented (1984, 27 Footnote 52) that both the IRS and the Estate argued for an ambulatory interpretation in *Burghardt Estate*, and that “Neither party contended for the static interpretation, that the taxpayer was entitled to the original exemption even though it did not currently exist under internal law.”

I disagree with these comments – for three reasons. Firstly, a static interpretation only involves the adoption of the original meaning of a tax treaty term; it does not involve advancing the untenable argument that a tax treaty can preserve a deduction which has been abolished by the same Legislature that originally granted it. It is neither customary (absent specific provisions to the contrary – see Chapter 9.09) nor, typically, constitutionally possible for tax treaties to endow any domestic (internal) laws with everlasting life.

Secondly, the IRS *did* argue that the original meaning of the term “specific exemption” should apply. The IRS argued that the original meaning denoted the \$60,000 deduction originally applicable at the time the treaty entered into force – so that the Estate could only claim this deduction (which was no longer available because Congress had abolished it).

Thirdly, the Estate *also* focused on the original meaning of “specific exemption”. It argued that this original meaning denoted (*italics added*) “*a method* by which small estates were exempted from tax”. It argued that this method was capable of evolution – so that, as this method evolved, the exemption evolved to encompass the unified credit.

This “evolutionary” argument was essentially accepted by Tannenwald C.J. – and his decision was followed in US: December 8 1986 *Mudry* (Article 3). *Burghardt Estate* and *Mudry* were both acquiesced to in Rev. Rul. 90-101 (which revoked Rev. Rul. 81-303 – see Chapters 28.18 and 29.02).

10.12 Belgium: December 21 1990 CC (Article 21)

December 21 1990 CC involved N, a Netherlands resident, who was an active partner

(“associé”) in SPRL, a Belgian société de personnes à responsabilité limitée (limited partnership). This partnership was not limited by shares.

The Belgian tax authorities argued that N was taxable on his share of SPRL’s business profits, pursuant to the “Business Profits” Article 7 of the 1970 Netherlands tax treaty. They argued that “in the absence of specific treaty dispositions in this matter” N was an “enterprise” of the Netherlands, and had a permanent establishment in Belgium – simply because it was an active partner in SPRL.

Article 2(4) of this treaty runs: “The Convention shall also apply to any identical or substantially similar taxes which are subsequently imposed in addition to, or in place of, the existing taxes. The competent authorities shall notify to each other any substantial changes which have been made in their respective laws.”

Article 3(2) of this treaty is comparable to Article 3(2) of the 1977 OECD Model.

On appeal, the Belgian tax authorities stressed that, when the tax treaty was signed in 1970, the income of an active partner in a SPRL which had not opted to be taxed as a company was considered to be business income under Article 20, 1° of the Belgian Income Tax Code (CIR). They argued that the Netherlands tax authorities had also understood this to be the case, and that the Cour de Cassation should give effect to the parties’ original intentions – and characterise such income as business profits.

The Cour de Cassation dismissed the tax authorities’ appeal. It held that because the tax treaty did not define the term “business profits”, Article 3(2) required Belgian tax law to define this term. Article 3(2) evidenced the Contracting States’ wish to give the Belgian legislator the exclusive competence to define “business profits” as regards Belgian enterprises. Although the income of an active partner might have been business profits when the treaty was originally negotiated, the characterisation of such income had been changed by the Belgian Law of January 5 1976. Under this 1976 Law, such income was employment income under Article 20, 2° CIR. This changed domestic characterisation had to be applied to the tax treaty. Accordingly, the income of an active partner could not now fall within Article 7. The fact that characterisations could change was recognised by Article 2(4). The “context” did not require any different interpretation to apply.

December 21 1990 CC illustrates the danger of excessive references to domestic law (see Chapter 8.14), especially as regards concepts (see Chapter 7.11) and characterisations (see Chapter 8.22), and the defects inherent in an ambulatory approach to Article 3(2) which ignores the importance of a tax treaty’s context. Its holding that a change in one State’s domestic law led to income being recharacterised for tax treaty purposes may be explicable by the fact that it led to this income ceasing to be taxable in Belgium. Whilst this may be consistent with a liberal interpretation of tax treaties in favour of taxpayers (see Chapter 11.02), it may also have led to double non-taxation.

When the 1970 Netherlands tax treaty was originally concluded, both States agreed that the income of an active partner in a partnership was business income. Although

this original meaning could have evolved, there is no indication that it had done so. Accordingly, the Cour de Cassation should have focused on whether the subsequent Belgian legislation (which characterised partnership income as employment income) was consistent with the meaning of the term “business profits” in its tax treaty context. It is more than arguable that this new characterisation was not consistent with the tax treaty meaning of this term. Accordingly, the Cour de Cassation should have held that Article 3(2)’s reference to domestic law should not apply – because *the context* of the treaty otherwise required. On this basis, the treaty still allocated the right to tax the income to Belgium. However, this allocation would not necessarily mean that Belgian tax was due – because it would then have to be proved that Belgium actually did levy tax on such income pursuant to its domestic characterisation of this income as employment income, and that no estoppel (see Chapter 28.19 onwards) existed.

Following *December 21 1990 CC*, Netherlands: March 25 1992 Ruling (Article 16) holds that the competent authorities of the Netherlands and Belgium have now agreed that an active partner’s income from an SPRL will be taxed as directors’ fees – and not as business profits (as, apparently, the two States had originally agreed). This Ruling is referred to in Chapter 27.23.

10.13 *The appropriate scope of Article 3(2) of the OECD Models*

In relation to the two “unless the context otherwise requires” provisos in Article 3 of the 1977 OECD Model, Vogel commented (1991, 109): “... those provisos used in Anglo-American law have no function other than to provide the judge with a degree of freedom in interpretation (a “value”) which the continental judge enjoys in any event without any such express proviso. Its significance should, therefore, not be overestimated.” However, it is difficult (if not, in view of range and intensity of the debates, impossible) to ignore the fact that the correct interpretation of these provisos is of the most fundamental importance.

Be this as it may, once it has been accepted that Article 3(2) does not permit unilateral domestic changes which amount to a deliberate breach of a tax treaty, and in view of the conclusion in Chapter 8.14 that references to domestic law should be discouraged, what is the scope of Article 3(2)? To re-phrase this question: by including a provision comparable to Article 3(2) in a tax treaty, to what extent has a State agreed in advance that domestic laws, possibly those of the treaty partner State, should govern the interpretation of the treaty (by that State)? The answer to these questions depends largely upon the interpretation of the words “unless the context otherwise requires” in the States concerned.

If State A fails to appreciate the importance of a tax treaty’s “context” – or interprets the word “requires” strictly, so that the context can almost never require – its treaty partner States must anticipate that State A (or its courts) will typically define tax treaty terms by reference both to State A’s existing parochial tax definitions (which State A’s treaty partner States may be unaware of, or may not understand) and to State A’s future domestic tax definitions – which they may understand less and/or may even object to.

Unless State A's treaty partner States agree with this approach, it conflicts with the principle that terms in a bilateral tax treaty should be interpreted in accordance with what both parties originally agreed – see Chapter 5. It is also likely to lead to the same treaty terms being interpreted differently by different States.

For these reasons, the 1992 ALI Report recommends (perhaps too hesitantly) (61) that Article 3(2)'s requirement to apply domestic law except where “the context otherwise requires”, should “be interpreted liberally in the light of the general desirability of developing uniform international interpretations of commonly used treaty terms.”

In view of the existing wording of Article 3(2) of the 1977 and 1992 OECD Models, it is understandable that domestic tax authorities have frequently ignored the importance of the bilateral context in which tax treaty terms appear. Tax authorities may be reluctant to contemplate the loss of sovereignty and revenue which even a partial application of a treaty partner State's definitions might, at first sight, entail.

Perhaps less understandably, some courts have also taken the same stance – see Australia: April 12 1957 *Case J35* (Article 2). *Case J35* involved the 1953 US tax treaty, which contained a provision comparable to Article 3(2). Mr. Fletcher commented (9 TBRD 168): “I am of the opinion that in considering the articles of the *Double Tax Convention*, which Convention is incorporated in the Australian law, the Australian interpretation should be applied except where the Convention is specific.”

A more commendable approach is discernable in more recent decisions.

As Chapters 5.04 and 19.01 illustrate, a contextual approach was adopted in Sweden: December 23 1987 *Supreme Court* (Article 13) which involved Article II(2) of the 1960 UK treaty (which contained a provision comparable to Article 3(2) of the 1977 OECD Model). The majority held that particular attention should be paid to the English text of Article II(2), because the treaty negotiations had been conducted in English – see Chapters 20.04 and 20.05. In UK tax law the words “income from a source” in Article II(2) had a special meaning (see Chapter 19.02) – which did not include capital gains. The corresponding words in the Swedish text (*inkomst från inkomstkälla*) had no technical meaning under Swedish tax law. Furthermore, the UK Revenue had consistently been of the opinion that capital gains were not covered by Article II(2). If the Supreme Court held otherwise, it would be applying the treaty asymmetrically.

As Chapter 21.03 illustrates, Switzerland: May 10 1989 *Zurich Commission* (Article 15) also adopted a contextual approach in relation to the 1951 US tax treaty (which did not contain a provision comparable to Article 3(2) of the 1977 OECD Model). The Commission held that because the words “temporarily present” were undefined in the treaty they were to be interpreted, not in accordance with Swiss law, but in accordance with public international law and the intention of *both* Contracting States. The Commission found the English text to be the more helpful – see Chapter 20.04.

Hopefully, more domestic courts will henceforth recognise that unilateral domestic law (in either State) should only be applied if it is consistent with the meaning of the tax treaty terms in their international context – that of a bilateral treaty.

This approach requires (a court in) one State to consider how a treaty partner State intended the treaty terms in issue to be interpreted – possibly by applying this State’s own domestic definitions. Although consideration of a treaty partner State’s intentions may seem to involve of a loss of sovereignty, in reality any loss of sovereignty will have already occurred at the time the tax treaty was entered into.

At present, by providing that the tax law of the State applying a tax treaty is to govern the meaning of terms not defined therein, Article 3(2) serves a stop-gap function that could facilitate the interpretation of some undefined terms. However, as Lenz commented (1960, 297) decades ago: “If such a [general renvoi] clause is used only when other methods prove inadequate it is wholly superfluous because in practice the authorities of the State will in any case turn to the domestic law as a last resort.”

Because courts can – and do – turn to domestic law in any event, it is arguable that provisions comparable to Article 3(2) have simply diverted attention away from the need to find a contextual meaning which reflects the common intention of both States – see Chapter 5. Such has been the enthusiasm of courts and tax authorities to refer to *one* State’s domestic law pursuant to provisions comparable to Article 3(2) that they have often ignored the context of tax treaty terms – see Chapters 7-10.

The fact that courts and tax authorities have applied domestic definitions with excessive enthusiasm, and the possibility that they may also consider unilateral changes to be facilitated by Article 3(2), is understandable. This situation has arisen because Article 3(2) and its Commentaries do not stress sufficiently that unilateral domestic definitions should only govern the meaning of tax treaty terms to the extent that they are consistent with the meaning of these terms in their bilateral tax treaty context – i.e. if the treaty partner State has agreed to them, either explicitly or implicitly.

However, a revision of the *text* of Article 3(2) so as to accentuate the importance of “context” and diminish the importance of domestic law is, at present, as unlikely as it would be welcome – for four reasons.

Firstly, the same result can be achieved by correctly stressing the importance of the tax treaty *context* of tax treaty terms.

Secondly, the Committee on Fiscal Affairs, whilst not averse to changing the Commentary on unchanged Articles, is reluctant to change the texts of these Articles – no doubt because changed Articles might well be interpreted differently to their predecessors. Perhaps for this reason, the Commentary on the 1992 OECD Model takes the view that the wording of Article 3(2) is satisfactory – and has left it unchanged.

Nevertheless, and thirdly, the OECD Committee on Fiscal Affairs may feel that it is desirable to confirm the accuracy of this interpretation by further changes to the Commentary on Article 3. Article 3(2)’s Commentary could easily be revised (again!) to confirm that the word “requires” should be interpreted liberally – so as to accentuate the importance of a tax treaty’s “context”. The impact of such changes to Commentary on otherwise unchanged Articles is discussed in Chapter 26.04 onwards.

Fourthly, some tax authorities (notably those in the US), have traditionally been in favour of tax treaties being interpreted by reference to (their own) domestic law –

perhaps because this may increase their fiscal sovereignty (see Chapter 10.01).

An extreme, and extremely regrettable, example of such a preference for the application of each State's domestic law is the omission of Article 3(2)'s key words "unless the context otherwise requires" in Article 3(2) of the 1982 Italy/Yugoslavia tax treaty. This omission may, however, be explicable by the fact that the sole authentic text of this treaty is in English – see Chapter 20.05.

Were Article 3(2) or its Commentary to be revised to stress the importance of a contextual meaning, inappropriate references to *one* State's domestic laws would decrease.

The difficulty remains: what if the context does not obviously require a particular meaning to apply – and each State's domestic definitions conflict?

Avery Jones *et al.* argue (1984, 50-54 – see Chapter 8.20) that in this case priority should be given to the source State's domestic definitions – however aberrant these may be – simply to avoid conflicts. For the reasons also given in Chapter 8.20, this argument may not often find favour. A more appropriate course is to stress the importance of finding a contextual meaning – and to include provisions in tax treaties which themselves enable such conflicts to be resolved. If this is done – and, hitherto, it has only been done rarely – more contextual meanings are likely to emerge. If, nevertheless, different courts do find different contextual meanings or, in the rare absence of any contextual meaning, do apply their own domestic tax laws even if they conflict with those of their treaty partner State, so be it. Such differences and conflicts are an inherent aspect of the sovereignty of States. It is more than likely that States have always intended to tolerate such marginal differences as may arise (as they do in other fields) – and that they have always considered these differences to be best resolved by the mutual agreement procedure or by appropriate revisions to a tax treaty. It is less than likely that, whenever a conflict arises, States have always intended to force a residence State to adopt every source State definition.

Chapter 11 Article 31(1): Object and purpose

Article 31(1) of the Vienna Convention runs: “*General rule of interpretation*

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”

The “ordinary meaning” to be given to tax treaty terms in their (tax treaty) context must reflect the treaty’s *object and purpose*. However, most tax treaties have several (general) objects and purposes, as the headings below indicate. In addition, specific tax treaty provisions may have specific purposes which are consistent with fulfilling the treaty’s (general) purposes. The extent to which effect should be given to such objects and purposes is discussed in Chapter 6.

11.01 *The avoidance of double taxation*

The avoidance of double taxation is the most important object and purpose of almost all tax treaties. In some tax treaties it is the sole expressed purpose. For example, the 1977 OECD Model is entitled (italics added): “Model Convention for the *avoidance of double taxation* with respect to taxes on income and on capital”. This Model mentions no other object or purpose – but other purposes exist, as indicated below.

However, the 1992 OECD Model is succinctly entitled: “Convention between (State A) and (State B) with respect to taxes on income and on capital”.

This 1992 change in the OECD Model’s title was doubtless made to remove the implication in the 1977 Model that the avoidance of double taxation was its sole purpose – and to imply that both Models may have other purposes, including “the prevention of fiscal evasion”.

Accordingly, Footnote 1 to the 1992 OECD Model’s title runs (italics added): “1. States wishing to do so may follow the widespread practice of including in the title a reference to either the elimination of double taxation or to both the elimination of double taxation and *the prevention of fiscal evasion*.”

11.02 *To avoid double taxation, some courts have interpreted tax treaties liberally*

Courts often interpret tax treaties so as to achieve their principal purpose of avoiding double taxation. They are often reluctant to apply the ordinary meaning of tax treaty terms if this results in double taxation – or its opposite, double non-taxation.

There is considerable authority that tax treaties should be interpreted liberally – in favour of taxpayers – if this results in the avoidance of double taxation.

If there is no risk of double taxation, a less liberal (and possibly more literal) approach may be adopted in practice; domestic laws (imposing tax) may also be more likely to apply to govern the meaning of undefined tax treaty terms. For example, in US: January 16 1963 *Samann* (Article 25 and see Chapter 28.14) Judge Bryan commented (313 F.2d 463): “No indication is given by the Convention to alter the pattern of income taxation prevailing in either nation. The sole object, to repeat, is to

avoid assessment in both countries of the same income.”

If income or capital may attract a lower than average tax charge, or avoid tax altogether, an even less liberal approach may be adopted in practice – to prevent the double avoidance of tax (double non-taxation).

In New Zealand: September 11 1992 *Case P72* (Article 19) the taxpayer argued that a NZ Government pension, which the 1980 Canada tax treaty exempted from tax, should only suffer 15% NZ tax. Under this argument, in Barber D.J.’s words (14 NZTC 4,488): “The taxpayer would have the benefits of a lower rate of NZ tax than other such pensioners and of exemption from further tax in Canada. This could not be the intention of a Convention aimed at affording relief from double taxation.”. Barber D.J. continued (14 NZTC 4,489): “The purpose of the Convention is to eliminate double taxation rather than to create a lower overall rate for some categories of pension.”

In US: March 25 1955 *Lewenhaupt* (Article 13 and see Chapter 28.12) Harron J. commented (20 T.C. 160): “The purpose of the tax convention is the avoidance of double taxation. It was not designed, as the petitioner urges here, to exempt a class of income from taxation by both of the contracting states.”

Similarly US: September 12 1968 *NCR* (Article 23) held that because the avowed purpose of the 1945 UK tax treaty was the “avoidance of double taxation and the prevention of fiscal evasion”, NCR was not able to obtain a credit for UK taxes both under the treaty and under domestic law; this would have amounted to the double avoidance of taxation.

Again, in US: February 20 1974 *Suez* (Article 3) Laramore J. held (492 F.2d 810): “Ultimately this case also turns on the intent and purpose of the Convention as agreed upon by the signatories. The purpose and intention of the Tax Convention between the US and France was to avoid double taxation and to alleviate the problems arising from it. The parties to a bilateral agreement are primarily concerned with removing an obstacle to the flow of trade and investment between their two countries.”

Laramore J. concluded (492 F.2d 811): “The fact is that the plaintiff is not confronted with a problem of double or burdensome taxation that the treaty was designed to alleviate or eliminate. There is no double tax on the income of the plaintiff since it is not taxed in France. There is no obstacle to trade or commercial intercourse in the context of this case, and considerations of fiscal evasion are not involved. ...

The plaintiff claims, based on the treaty, that an adverse decision would violate the rule of comity. This is not so because the only tax authority involved is that of the US. If the US surrendered its authority in accordance with the plaintiff’s claim, it would gain nothing for which it negotiated under the treaty. Also, France has no interest in this matter because its authority to tax is not involved. France disclaimed its right to tax the income in dispute. United States’ interests and benefits are the only ones involved relative to the Convention, therefore a result unacceptable to the plaintiff, either based on the Convention or indirectly structured through an unfavorable choice of law, in no way violates the principles of comity. The decision merely protects the principle of the

Convention, avoidance of double taxation.”

Despite the above, the general rule must still be that the ordinary meaning of tax treaty terms must be applied – even if a tax treaty’s primary purpose of avoiding double taxation is not fulfilled. One reason for this is that, as Para. 1 of the Commentary on the Article 23 of the 1977 and 1992 OECD Models recognises, these Models may not avoid “economic” double taxation – because they only deal with “juridical” double taxation. Furthermore, these Models may sometimes even fail to achieve their principal purpose of avoiding double juridical taxation; this is the main reason why they contain the Mutual Agreement Procedure Article 25.

Similarly, tax treaties must be applied even if double non-taxation results.

For example, Netherlands: *May 28 1984 Hertogenbosch GH* (Article 6) held that the 1957 Canada tax treaty exempted a resident of the Netherlands from Netherlands tax on interest from a Canadian mortgage – even though this interest was not taxable in Canada under Canadian domestic law.

In US: February 2 1981 *Holmstrom* (Article 18), a national of Sweden (residing in Monaco) contended, inter alia, that his pension was exempt from US (withholding) tax under the second paragraph of Article X of the 1939 Sweden tax treaty.

Dumbauld D.J. held that Holmstrom’s pension was exempt from US (withholding) tax, commenting (512 F.Supp. 556 and 557): “Defendants [PPG *et al.*] manifest curiosity as to whether plaintiff would pay tax in Sweden on the benefits received under the plan. But that is none of their concern. Plaintiff’s liability for Swedish tax, as a resident of Monaco, is a matter between him and the Swedish tax authorities. Whether Sweden chooses to tax all income of Swedish nationals regardless of residence, or treats non-residents differently from residents, is a matter to be regulated by Swedish legislation, without regard to the views of PPG’s plan administrator. If plaintiff, acting in accordance with Learned Hand’s familiar maxim [*Footnote 4*: “Over and over again courts have said that there is nothing sinister in so arranging one’s affairs to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions not voluntary contributions. To demand more in the name of morals is mere cant.” *Commissioner v. Newman*, 159 F.2d 848, 850-51 (C.C.A. 2, 1947).] manages his affairs so as to take advantage of arrangements permitted by Swedish law which reduce his tax burden, PPG can not complain. Its ox is not gored.”

Indeed, courts in the Netherlands and Sweden have construed tax treaty provisions designed to prevent the avoidance of double taxation so literally that double non-taxation has resulted.

For example, Netherlands: *January 26 1977 HR* (Article 18 and see Chapters 20.04 and 25.02) held that the 1967 UK tax treaty exempted a pension from tax in the Netherlands even though the UK resident pensioner suffered no UK tax on this pension.

Similarly, Sweden: *December 23 1987 Supreme Court* (Article 13) held that the 1960 UK tax treaty exempted a capital gain from tax in Sweden, even though the UK

resident vendor suffered no UK tax on this gain.

In both decisions UK tax was avoided because the pension/capital gain was not remitted to the UK, and in both decisions tax treaty anti-avoidance provisions designed to preclude treaty benefits being claimed in respect of sums not remitted to the UK were held not to apply to the sums in question.

11.03 Textual and purposive (liberal) interpretations

The following examples illustrate the conflicts that can arise between interpreting a tax treaty in accordance with its ordinary meaning – and interpreting it liberally in the light of its purpose of avoiding double taxation.

Australia: September 10 1968 *Emanuel* (Article 10) and June 5 1969 *ES&A Bank* (Article 7) held that courts are not entitled to ignore the tax treaty language used – even when this has not lead to double taxation being avoided; double taxation is only to be avoided to the extent provided for by a tax treaty.

However, in Australia: August 22 1990 *Thiel* (Article 7) Northrop J. (whose dissenting judgment in the Full Federal Court was essentially adopted by the Full High Court) commented (89 ATC 4,022 and 4,023): “The policy behind the agreement is to avoid the imposition of double taxation with respect to taxes on income. That is a stated purpose of the agreement. If possible, the proper construction of the agreement should be consistent with that policy or purpose.”

Belgium: March 2 1970 *Brussels CA* (Article 18) held that the 1953 UK tax treaty should be interpreted as widely as possible so as to avoid double taxation. On this basis, it held that a “pension” should include an allowance.

However, Belgium: February 14 1986 *Ghent CA* (Article 23 – affirming the Cour de Cassation) held that when the 1970 Netherlands treaty did not address a situation in which double taxation arose, it should be interpreted as it stood – even though its purpose of avoiding double taxation would not thereby be achieved.

Canadian courts have often interpreted tax treaties liberally. In Canada: November 30 1954 *Saunders* (Article 19 and see Chapter 14.01) Chairman Fordham commented (54 DTC 526): “The accepted principle appears to be that a taxing Act must be construed against either the Crown or the person sought to be charged, with perfect strictness – so far as the intention of Parliament is discoverable. Where a tax convention is involved, however, the situation is different and a liberal interpretation is usual, in the interests of the comity of nations. Tax conventions are negotiated primarily to remedy a subject’s tax position by the avoidance of double taxation rather than to make it more burdensome. This fact is indicated in the preamble to the Convention. Accordingly, it is undesirable to look beyond the four corners of the Convention and Protocol when seeking to ascertain the exact meaning of a particular phrase or word therein.”

Chairman Fordham’s comment has often been approved – see Canada: July 3 1975 *Shahmoon* (Article 5 and Chapter 9.12), March 17 1976 *Canadian Pacific* (Article 12 and below), September 28 1982 *Melford* (Article 7 and Chapter 10.08), January 28 1985 *Gladden Estate* (Article 13, Chapter 9.16 and below), October 31 1985 *Canada-*

Israel (Article 23 – implicit approval) December 1 1987 *Scott Estate* (Article 18), December 14 1987 *Chhabra* (Article 6 and see below), April 26 1991 *Gu* (Article 15 and below) and June 5 1992 *Hale* (Article 15 and below). However, these approvals often precede widely different approaches – some interpreting tax treaties liberally in favour of tax authorities (in line with their intentions) and others interpreting tax treaties liberally in favour of taxpayers (so as to avoid double taxation).

To avoid double taxation, *Canadian Pacific* adopted a treaty partner State's understanding of the meaning of treaty terms – see Chapter 28.04. This approach was approved in December 14 1987 *Chhabra* by Cullen J. (in a debatable comment – 88 DTC 6023 and 6024 and see Chapter 8.22); Cullen J. also approved of the following comment by Addy J.

In *Gladden Estate* Addy J. commented (85 DTC 5191): “Contrary to an ordinary taxing statute a tax treaty or convention must be given a liberal interpretation with a view to implementing the true intentions of the parties. A literal or legalistic interpretation must be avoided when the basic object of the treaty might be defeated or frustrated insofar as the particular item under consideration is concerned.”

After citing Chairman Fordham's comment, Addy J. added: “The courts of the US, the other signatory of the Tax Convention in issue here, have come to the same conclusion as to the method of interpreting treaties of this nature. (Refer decision of U.S. Supreme Court in the case of *Re Ross*, 140 U.S. 1891 [*sic* – (1891) 140 U.S. 453] [and US: May 5 1982 *Great-West* – Article 7]).” Despite Addy J.'s views, *Great-West* is more consistent with “a liberal interpretation” of tax treaties in favour of tax authorities, rather than taxpayers – and its reliance upon extra-textual materials can be criticised (see Chapters 6.05 and 25.09).

Addy J. then fully agreed with and adopted the following statement by Ward (1977, 264, italics added): “... the weight of authority would appear to be against the type of strict interpretation of a tax treaty which would normally be applied to an *exempting* provision of fiscal legislation.”

In Canada: November 8 1993 *Crown Forest* (Article 4) Muldoon J. in the Trial Division cited these comments by Addy J. as support for his earlier assertion (92 DTC 6305): “it appears then to be quite legitimate to give full rein” to an expression the 1980 US tax treaty. However, in giving this expression “full rein”, Muldoon J. arrived at a conclusion which conflicted with the intentions of the treaty partner States, probably led to double non-taxation, and was difficult to reconcile with the ordinary meaning of the treaty text.

Gu also cited Chairman Fordham's statement with approval – but it primarily holds that tax treaty language should not be ignored or artificially extended. Bonner T.C.J. commented (91 DTC 823): “In seeking the meaning of a provision in an international treaty, it would undoubtedly be wrong to apply strict rules of interpretation. On the other hand, one must not, in an attempt to achieve what one conceives is or ought to be the object and purpose, ignore or artificially extend the meaning of the language employed by the signatories to the treaty.”

Similarly, in *Hale*, Desjardins J. stressed (92 DTC 6372) that Chairman Fordham's comment should only be applied to achieve "the avoidance of double taxation", and noted his comment that "it is undesirable to look beyond the four corners of the Convention." It is ironical that the judges in *Hale* did not look sufficiently carefully within the four corners of the Convention – see Chapter 8.17.

In Canada, the desirability of avoiding double taxation has also led to tax treaty terms being given a meaning wider than their dictionary meaning (see Chapter 7.03).

Thus, in Canada: June 9 1977 *Cruickshank* (Article 18) Gibson J. held (77 DTC 5227): "In my view the word "pension" as used in Article II of the Canada-France Convention Act in reference to a private pension paid to "persons having their fiscal domicile in the other (contracting) State" should be given a wider meaning than its lexicon meaning and in such wide meaning includes a payment which may be categorized as a "superannuation or pension benefit" as used in the *Income Tax Act*." This holding was approved by Addy J. in *Gladden Estate* (85 DTC 5191).

In Canada: January 30 1979 *Appleby* (Article 18) Mr. D.E. Taylor's perception of what constituted double taxation led him to adopt an extremely liberal interpretation of tax treaty terms. He held that the 1966 UK tax treaty allowed a Canadian resident to deduct maintenance payments – because his ex-wife suffered UK tax thereon.

In France: *January 15 1992 CE* (Article 10) Commissaire Hagelsteen concluded: "It nevertheless seems to us that in general if one wishes international tax treaties to exactly fulfil their purpose, which is to avoid double taxation, it is necessary to interpret this kind of provision in the most precise sense possible and, in the absence of more specific provisions, to adopt in effect, as the event triggering taxation, the "effective payment" or "the effective encashment", in order to avoid all hesitation in one or the other State, on the fiscal treatment of the sums in question."

Germany: *January 20 1993 BFH* (Article 7) held that it could sufficiently discern the purpose of Article XIV(2) of the 1954 US tax treaty as being to preclude the extraterritorial taxation of interest. It therefore overruled *October 9 1985 BFH* (Article 7), which had held that the ordinary meaning of the terms in Article XIV(2) led to interest (and hence an interest "spread" or profit) avoiding tax in Germany – see Chapter 6.05.

Italy: *October 17 1983 Rome Commission* (Article 23) held that when the 1955 US tax treaty failed to avoid double taxation, the imposition of tax might be unconstitutional. Accordingly, the case was referred to the Constitutional Court.

In Rhodesia: August 12 1966 *Tetra Pak* (Article 7) Beadle C.J. commented (28 SATC 217): "The object of a statutory instrument is often a useful aid to interpretation and here it must be borne in mind that the object of this particular statutory instrument is to avoid double taxation. All other things being equal, therefore, an interpretation which achieves this object should be favoured above one which does not. This was the approach of Upjohn J. (as he then was) in *Ostime's* case [UK: July 16 1959 *Ostime* – Article 7 and see Chapter 26.15] [1958] 1 All E.R. 305 (Ch.D.) at 312, and this

approach was not criticized when the case eventually went on appeal to the House of Lords and where Upjohn J.'s decision was confirmed."

UK courts tend to apply treaty words literally – whether this results in double taxation (or its opposite, double non-taxation).

Thus, in UK: December 1 1960 *ICI* (Article 23) income in one year was calculated by reference to a year in which a credit had already been given for Australian tax. The Court of Appeal held that no (double) credit was permissible – even though this resulted in double taxation. In contrast, the House of Lords held in UK: April 8 1965 *Gollan* (Article 23) that a taxpayer was allowed a credit in the UK for tax which had never actually been paid in New Zealand.

Lord Donovan (who was a Judge in both *ICI* and *Gollan*) accepted that both these decisions could produce anomalies. In the House of Lords in *Gollan* he commented (42 T.C. 349 and 350): "As regards the assertion that anomalies will follow from acceptance of the Respondent's interpretation, I think one must remember that any scheme designed to give relief in one country from Income Tax suffered in another on the same income for the same or a corresponding period is productive of many difficulties, not all of which can be perceived and provided against in advance. The disputes which have come before the Court in this connection amply bear this out. In these circumstances, anomalies cannot be treated as a satisfactory guide in matters of construction, though no doubt there are cases where they may turn the scale. The present is not such a case, and the Courts can here do no more than look at the language used and give it a fair and reasonable construction."

More recent examples of UK courts ignoring "purpose", and applying the ordinary meaning of a tax treaty's terms even when this resulted in total non-taxation, are June 23 1972 *Strathalmond* (Article 4), May 19 1989 *Padmore* (Article 3) and February 9 1990 *Commerzbank* (Article 7).

Strathalmond held that the 1945 US tax treaty exempted a US citizen resident in the UK from UK tax on US source investment income remitted to the UK – see Chapter 7.12.

Padmore held that the 1952 Jersey tax treaty exempted a UK resident partner in a Jersey partnership from UK tax on his Jersey partnership income.

Commerzbank held that the 1945 US tax treaty exempted UK branches of a German and a Brazilian bank from UK tax on interest paid to them by US corporations – see Chapter 6.05.

Padmore and *Commerzbank* have both had to be reversed by UK legislation; Canada has also introduced legislation to reverse *Padmore*.

In US: December 8 1986 *Mudry* (Article 3), Senior Judge White approved (86-2 USTC 86,290) of the comment that where: "... a treaty fairly admits of two constructions, one restricting the rights which may be claimed under it, and the other enlarging it, the more liberal construction is to be preferred." Judge White noted that this comment had been made in the 1933 US Supreme Court decision of *Factor v. Laubenheimer* (290 U.S. 276 at 293-94). However, this comment originated in the

1928 US Supreme Court decision of *Jordan v. Tashiro* (278 U.S. 214 at 218), when the Supreme Court discussed reciprocity – see Chapter 5.02 (which gives the sentence preceding this quotation).

11.04 *The prevention of fiscal evasion and the exchange of information*

The 1977 OECD Model does not specifically mention the prevention of fiscal evasion as a purpose – even though this is the clear aim of its Exchange of Information Article 26. Perhaps those responsible for drafting this Model considered that the role of Article 26 is simply to discourage tax evasion by providing tax authorities with the means to detect tax evasion, and that a tax treaty may not be capable of preventing fiscal evasion by facilitating information exchanges which are not permissible under domestic law (see Chapter 13).

However, Footnote 1 to the 1992 OECD Model's title provides (italics added): "1. States wishing to do so may follow the widespread practice of including in the title a reference to ... the elimination of double taxation *and the prevention of fiscal evasion.*"

Many US treaties (and the US 1977 and 1981 Models) specifically mention "the prevention of fiscal evasion" as a second purpose, and it is arguable that "limitation on benefits" and all anti-treaty-shopping provisions have such a purpose.

In some jurisdictions, "fiscal evasion" may only cover (illegal or fraudulent) tax evasion and not (legal) tax avoidance. However, this may not be the sense in which this term is used in tax treaties.

For example, in New Zealand: October 2 1992 *Squibb* (Article 26) Eichelbaum C.J. commented (13 NZTC 8,133): "The preamble to the Agreement sets out its purposes as the "avoidance of double taxation, and the prevention of fiscal evasion with respect to taxation on income". Taken by itself, in the context of a preamble I would not place undue emphasis on the term "evasion". Although in tax parlance it is generally taken to connote the deliberate avoidance of tax liability, in a popular sense it is capable of being regarded as referring more broadly to any situation where less tax is being paid than ought to be the case."

The extent to which the scope of a tax treaty is altered by the (widespread) addition of the "prevention of fiscal evasion" as a purpose is debatable – because it is generally accepted that tax treaties cannot normally impose tax (see below). However, the inclusion of this second purpose may facilitate exchanges of information.

In US: May 11 1981 *Vetco* (Article 26) Skopil J. commented that one of the purposes of the 1951 Switzerland tax treaty is to prevent fraud – although its preamble simply describes it as being "for the avoidance of double taxation". Skopil J. no doubt had in mind this treaty's Article XVI – which permits the competent authorities to exchange (italics added) "such information as is necessary for carrying out the provisions of the present Convention or for the *prevention of fraud* or the like in relation to the taxes which are the subject of the present Convention."

Skopil J. held (644 F.2d 1328 Footnote 4): "It does not appear in this case that it is necessary to limit the summons power to avoid negating the purpose of the Swiss-US

tax treaty. One of the purposes of that treaty is to prevent tax fraud. 2 U.S.T. at 1760. Issuance of the summons in this case will further that purpose, not negate it.”

The fact that a treaty may not contain provisions designed to combat tax evasion may restrict its usefulness – even to taxpayers. For example, as noted in Chapter 24.07, Article 990 D CGI imposes a 3% annual tax on the value of property in France owned by nonresident entities. However, Article 990 E 2° CGI grants an exemption from this tax to “those entities, the seat of which is situated in a country or territory which has concluded a treaty [which provides] for administrative assistance to combat tax fraud and tax evasion ...”. As indicated in the *Editorial in The International Tax Treaties Service on France: July 10 1989 CC (Article 24), July 8 1988 Paris TGI* (not analysed separately) holds that a Swiss company cannot benefit from this Article 990 E 2° CGI exemption – because the 1966 Switzerland tax treaty does not provide for administrative assistance with a view to combating tax fraud and tax evasion, and only aims to diminish double taxation. (The Swiss company succeeded in avoiding this 3% tax on non-discrimination grounds.)

11.05 *The collection and enforcement of taxes; the revenue rule*

Tax treaties have not generally had, as one of their objects, the collection of a treaty partner State’s taxes. This is partly because of domestic constraints (such as the Due Process Clause of the US Constitution – see Shay 1993, 343) and partly because, as Steel J. commented in US: July 3 1967 *Horst* (Article 26; 270 F.Supp. 368 and 369): “It is a general rule of international law that in the absence of a treaty provision, one country will not enforce tax claims of another country. *Newcomb v. Commissioner of Internal Revenue*, 23 T.C. 954, 960 (1955); *Government of India v. Taylor*, [1955] 1 All Eng.L.Rep. 292 (H.L.1955).” This general rule is known as “the revenue rule”.

In US: March 23 1979 *Gilbertson* (Article 26 and see Chapter 13.01) Blaine Anderson J. concluded (597 F.2d 1166): “The revenue rule has been with us for centuries and as such has become firmly embedded in the law. There were sound reasons which supported its original adoption, and there remain sound reasons supporting its continued validity. When and if the rule is changed, it is a more proper function of the policy-making branches of our government to make such a change.”

Nevertheless, some tax treaties have long had the collection of tax as a purpose. It is likely that such a purpose will feature in more bilateral (and multilateral) tax treaties in the future – thereby further eroding the revenue rule.

When such a purpose exists tax can, typically, only be collected for a foreign State when its tax is finally due – see France: *January 5 1987 Paris TA* (Article 26). However, attachments may be permitted before it is determined whether foreign tax is due – and irrespective of the merits of the foreign State’s tax claim. For example, France: *April 16 1992 Lyon CAA* (also Article 26), involving the 1959 Germany tax treaty, holds that no French court is competent to adjudicate upon the validity of foreign tax claims. This position may be overly unfavourable to taxpayers.

Be this as it may, there is increasing sympathy for the view that tax treaties should

facilitate the mutual collection and enforcement of taxes owed to treaty signatories. This view is evident in the 1981 OECD *Mutual Assistance Model* – see Chapter 23.09. It is also evident in the US.

For example, the 1992 ALI Report comments (122): “... in an era of global business activities and financial markets a rule flatly barring enforcement of all foreign tax claims – to the extent it now exists in the US – is no longer justified.” The 1992 ALI Report concludes (124 and 125): “Treaty authorization of recognition and judicial enforcement of foreign tax claims is a long overdue change of the common law rule barring enforcement of foreign tax claims. Due process and reciprocity concerns should play a primary role in determining whether to modify this traditional policy ... Certainly there are, however, treaty partners whose tax and judicial systems are sufficiently similar to those of the US to warrant reciprocal recognition of tax claims under appropriate conditions.”

Accordingly, the 1992 ALI Report’s Recommendation begins (124): “The US should include in income tax treaties with selected treaty partners provisions authorizing reciprocal judicial recognition and enforcement of tax judgments rendered by courts of the treaty partner.”

More cautiously, Winger has commented (1993, 436): “Perhaps the “rule” against the enforcement of foreign revenue laws internationally should be abrogated by a treaty network in the interests of “fairness”.”

11.06 *The prevention of discrimination*

The 1977 and 1992 OECD Models do not mention that one of their purposes is to prevent discrimination – even though Article 24 (Non-Discrimination) clearly has this purpose. In any event, it is unclear why non-discrimination provisions should be included in *tax* treaties. As Chapter 12.01 indicates, such provisions have a history going back centuries – and their inclusion in tax treaties probably owes more to convenience than logic. Perhaps for this reason, Canada has reserved its position on this Article since 1963 – as have Australia and New Zealand since 1977.

11.07 *The purposes of the 1979 UN Model*

The Introduction to the 1979 UN Model runs in part: “Broadly, the general objectives of bilateral tax conventions may today be seen to include the full protection of taxpayers against double taxation (whether direct or indirect) and the prevention of the discouragement which taxation may provide for the free flow of international trade and investment and the transfer of technology. They also aim to prevent discrimination between taxpayers in the international field, and to provide a reasonable element of legal and fiscal certainty as a framework within which international operations can be carried on ... In addition the treaties have as an object the improvement of co-operation between tax authorities in carrying out their duties.”

11.08 *Other purposes*

Tax treaties which differ from the above Models may have other purposes. For example, they may contain a “tax-sparing” clause with a purpose of encouraging investment.

11.09 *Facilitating international trade and investment*

Under the heading “The Purpose of Income Tax Treaties”, the 1992 ALI Report comments (1): “The principal function of income tax treaties is to facilitate international trade and investment ...”.

Nevertheless, tax treaties do not, typically, refer to this function as a purpose. Para. 3 of the Introduction to the 1977 OECD Model simply comments: “... it is superfluous to stress the importance of removing the obstacles that double taxation presents to the development of economic relations between OECD Member countries.”

Para 1 of the Introduction to the 1992 OECD Model echoes this comment, noting: “... it is hardly needed to stress the importance of removing the obstacles that double taxation presents to the development of economic relations between countries.”

Although the desire to facilitate international trade may motivate the negotiation of a tax treaty, it is arguable that a tax treaty based on the 1977 and 1992 OECD Models only has the narrower purposes of avoiding double taxation, fiscal evasion and discrimination and, to an extent, facilitating exchanges of information.

However, if one of the purposes of a tax treaty is to facilitate international trade or investment (or, as the taxpayer claimed in *US: March 23 1954 LMN* (Article 25 and see Chapter 28.11) “the encouragement of economic recovery” in the treaty partner State), a court may find it easier to deny its benefits.

Thus in *US: September 2 1964 Johansson* (Article 4) Rives L.J. commented (336 F.2d 813) “The primary objective of our treaty with Switzerland, as well as those with more than twenty countries, is the elimination of impediments to international commerce resulting from the double taxation of international transactions.”

Rives L.J. concluded (336 F.2d 814): “International trade will not be seriously encumbered by our refusal to grant special tax treatment to one only marginally, if at all, Swiss resident and only technically, if at all, employed by a paper Swiss corporation.”

11.10 *Allocating the right to tax income and capital; can a tax treaty impose tax?*

It has long been accepted that tax treaties allocate the right to tax. Thus, a 1933 draft convention prepared by the Fiscal Committee of the League of Nations (see Chapter 23.09) was entitled “Draft Convention for the Allocation of Business Income between States for the Purposes of Taxation”.

Nevertheless, even though the allocation of the right to tax is fundamental to the operation of a tax treaty, modern Models and tax treaties never mention it as a purpose. This is because such allocation is inherent in the process of avoiding double taxation – a tax treaty’s primary purpose. Upon entering into a tax treaty, a State voluntarily restricts its right to tax – and thus avoids double taxation. This self-imposed restriction

inherently involves the allocation of the right to tax to the other State.

In Canada: February 19 1992 *Utah Mines* (Article 7 and see Chapter 14.01) Hugessen J. A. commented (92 DTC 6196): “It is quite clear that the purpose of the [1942 Canada/US] Convention is to avoid double taxation of enterprises doing business in the two countries and, to that end, to provide for the equitable allocation of the profits of such enterprises as between the two contracting powers. That purpose appears most clearly from the preambles both to the original Convention and to the amending Convention of 1950.”

The extent (if any) to which the allocation of the right to tax income or capital is a tax treaty purpose may be relevant to a key issue – namely, whether a tax treaty may impose or increase tax. If it is accepted that a tax treaty cannot impose tax, it is arguable that its rules for allocating the right to tax cannot do so either – unless this is a treaty purpose. Be this as it may, one principle is clear: to the extent that a State has been allocated the right to tax, it is free to decide for itself whether and how to exercise this right – see Chapters 9.17 and 10.04 onwards.

The fact that tax treaties do not include the allocation of the right to tax income or capital as a purpose is consistent with the view that States do not consider the allocation of taxing rights to be of as much importance as the avoidance of double taxation. This is because the allocation of the right to tax between States will typically be made on a reciprocal basis – see Chapter 12.01. Reciprocity and the exchange of information is discussed in Chapter 13.

11.11 “Equal effect” and “reciprocity”

Because tax treaty terms are typically expressed in reciprocal terms, courts may try and interpret them as having an “equal” effect or application. Frequently, however, tax treaties will not have an equal fiscal effect in each State – if only because each State’s tax laws may differ. For this same reason, reciprocally-expressed tax treaty terms may not, in practice, apply reciprocally. Accordingly, it cannot be a purpose of a tax treaty to achieve “equality of effect” in each State – see Chapter 12.

Equality of effect should not, however, be confused with non-discrimination – which tax, FCN and other treaties have sought to ensure for centuries (see Chapter 12.01).

Chapter 12 Reciprocity and equality of effect

12.01 *Treaties are often based on reciprocity*

Centuries before modern tax treaties emerged, States avoided discrimination by treaties that were conditional on reciprocity. Albrecht (1953) gives examples dating back to 1535 (involving the Ottoman Empire). Lidstone (1962) gives a brief history of reciprocal Foreign Commerce and Navigation (FCN) treaties starting from the mid-seventeenth centuries. Whether FCN treaties do guarantee equal treatment is debatable – because in some cases they may not be enforceable by taxpayers themselves (see Kaplan 1986, 211). FCN treaties were the inspiration for the reciprocal non-discrimination provisions in tax treaties.

Reciprocity has also long governed the enforcement of fiscal judgments (see Chapters 11.05 and 13.01) and underlies Social Security agreements (see New Zealand: December 23 1992 *Case Q11* – Article 18).

Prior to the evolution of tax treaties, States avoided double taxation by piecemeal legislation that was also conditional upon reciprocity. For example, when the UK's first comprehensive tax treaty (with the US, in 1945) received its second reading in the UK House of Commons, the Solicitor General commented (Parliamentary Debates, Official Report, Vol. 415, 495): "At the moment the legislation in this country is rather of a piecemeal nature. One of the Sections deals with reciprocal relief so far as the Dominions are concerned, and includes India." This legislation dated from 1916.

Similarly, under Sections 222 and 238 of the 1918 Revenue Act, the US allowed resident aliens a credit for foreign taxes in their home State – conditional upon reciprocity (see US: May 10 1948 *Freudmann* – Article 23).

From their inception, treaties for the avoidance of double taxation have also been expressed in reciprocal terms.

As Mitchell B. Carroll observed (1935, 587): "... some governments were disinclined to give up their tax revenues unless other countries should make reciprocal tax sacrifices." Thus, the first tax treaties (which covered shipping income exclusively) involved reciprocal exemptions from tax. These reciprocal exemptions were then extended to air-transport income.

The first US general income tax treaty (with France in 1932 – see Chapter 23.03) extended the principle of reciprocal exemption to cover (in the source State) patent and copyright royalties, private pensions and life annuities and (in the residence State) Government remuneration and war pensions. It also included a reciprocal provision exempting profits made on buying goods in one State for supply to the other State. More comprehensive subsequent tax treaties have, typically, also been expressed in reciprocal terms – as have piecemeal rulings (see, for example, Germany: August 21 1970 NR Westphalia Ruling (reciprocal exemptions for teachers) and *June 10 1976 Rheinland Pfalz FG* (reciprocal exemptions for pop groups) (both Article 14).

This long tradition of reciprocity raises two principal questions: should reciprocally-expressed tax treaty terms apply reciprocally – and should they have an equal effect in

each contracting State?

As this Chapter illustrates, tax treaties will not normally have an equal fiscal effect in each contracting State. This is because the effect of a tax treaty in each State will primarily depend upon each State's tax laws – and each State's tax laws will differ. The greater the similarity between two States' tax laws (or, as some tax officials say, the greater the structural reciprocity) the more likely it is that tax treaties will have equal effects in each State. The greater the dissimilarities between two treaty partner States' tax laws, the greater the likelihood of unequal effects.

Unequal effects thus result from difference(s) between two States' domestic tax laws – which tax treaties are powerless to amend. It cannot be a purpose of a tax treaty to achieve “equality” of fiscal effect or treatment in each State – and to change different States' different domestic tax laws so that they all become “equal”. Accordingly, the ordinary meaning of reciprocally-expressed tax treaty terms should not be distorted in an attempt to achieve “equality of effect”. A tax treaty must simply be applied – regardless of its effect (if any) in each State.

Two US decisions, *American Trust* (Chapter 12.02) and *Maximov* (Chapter 12.03), have long shown that “equality of effect” is not, and cannot be, an aim or purpose of tax treaties.

12.02 US: July 8 1957 *American Trust* (Article 4); equality of treatment

American Trust involved the plaintiff US trust and its four beneficiaries (who were all resident in the UK). The plaintiff made a capital gain – which it did not distribute to its beneficiaries. It nevertheless argued that this gain was exempt from US tax under the 1945 UK tax treaty (specifically Article XIV).

Article XIV ran in part (italics added): “A resident of the UK ... shall be *exempt* from US tax on gains made from the sale or exchange of capital assets.”

One of the plaintiff's contentions was that a principle of “equality” required the gain to be exempt from US tax. As Carter J. noted (141 F. Supp. 416 and 417): “Plaintiff also contends that the aim of the parties to the tax convention was equality of treatment in the taxation by each party of the nationals of the other party. From this plaintiff argues that because an American beneficiary of a trust held by a UK trustee would be wholly free from any burden of UK capital gains tax, that it must have been intended by the parties to the tax convention that in the reverse but like situation of UK beneficiaries of a trust with an American trustee, such as in the case at bar, that the beneficiaries should be freed from any burden of the US capital gains tax.”

Carter J. correctly rejected this contention. He pointed out that the “unequal” situation arose because one State (the US) imposed a tax which the other State (the UK) did not impose at the time. Carter J. continued (141 F. Supp. 417): “But the reason that an American beneficiary of a trust held by a UK trustee would be free from any burden of UK capital gains tax is, that there is no capital gains tax in the UK. One could just as well argue that a resident of the UK who held stock in an American corporation should be free from the burden of US capital gains taxes on sales of

corporate property, because an American stockholder in a UK corporation would not suffer the burden of a UK capital gains tax on sales of corporate property. This Court is not convinced that perfect equality of tax treatment was accomplished or intended to be accomplished by the tax convention on which plaintiff relies. Tax conventions are the product of long negotiations between the contracting parties. These negotiations usually consist of a series of tax concessions made by each party to the convention; therefore complete reciprocity is seldom possible.”

Carter J.’s holding was overturned by the Court of Appeals Ninth Circuit – but his holding remains valid because the Ninth Circuit was then effectively overruled by the Supreme Court in US: April 29 1963 *Maximov* (Article 4 and see Chapter 12.03).

Orr J.’s comments below in the Ninth Circuit in *American Trust* should, therefore, be treated circumspectly – despite the fact that they were approved in a minority opinion in US: August 25 1982 *Brown & Williamson* (Article 29 and see Chapter 12.04).

Orr J. commented (247 F.2d 153): “... “exempt” is nowhere defined in the Treaty, nor in the Internal Revenue Code of 1939. Therefore, we are required to construe the term “exempt” in accordance with what we believe to be the intent of the contracting parties, in order to achieve reciprocity between similarly situated US and UK taxpayers.

We think “exempt” was employed in its broadest meaning, signifying a release from economic burden. If the capital gains tax is imposed on the trust in the instant case, the UK beneficiaries and remaindermen are burdened economically with the US tax, as it diminishes both their respective incomes and corpus distributions.

We are not persuaded that the contracting parties intended such an economic burden be placed on UK taxpayers, when in a similar situation a US income beneficiary or remainderman would not have a similar burden arising from UK taxation.

A study of the Articles of the Convention indicates an attempt to achieve a thoroughgoing reciprocity between the two nations’ taxpayers in similar situations. Upon its face Article XIV does not portray any concession by the UK. The policy of reciprocity is apparent, however, when it is realized that the UK does not impose an income tax upon capital gains; it is obvious there was no occasion for any express concession on this point by it.”

As noted above, Orr J.’s views, stressing what he believed to be the intent of the parties (see Chapter 6.06), were not followed either by the Second Circuit or by the Supreme Court in US: April 29 1963 *Maximov* (Article 4).

12.03 US: April 29 1963 *Maximov*; equality of treatment is not a tax treaty purpose

In *Maximov* the Supreme Court denied a US trust an exemption from US capital gains tax – even though it was clear that, because the UK imposed no capital gains tax at the time, neither it nor its beneficiaries would suffer capital gains tax in the UK. The two main reasons for this (correct) denial were that the terms of the 1945 UK tax treaty did not grant the claimed exemption – and that it was not a tax treaty purpose to achieve “equality” of tax treatment (or, more accurately, of effect). Accordingly, the US was not forced to concede tax exemptions unilaterally offered by the UK.

In *Maximov* Clark J. in the Second Circuit commented (299 F.2d 568): “An examination of the full text of the Convention and the context of agreement indicates that, while one of the reasons Article XIV was included in the Convention was to achieve “equality” of tax treatment, imposition of a tax in the circumstances of this case would not be inconsistent with this objective. For the “equality” the parties strived for in this Article, as in similar provisions, was a limited one; they struck a rough bargain and were willing to tolerate marginal inequities of the sort involved in this case. While this dilutes the force of the taxpayer’s argument, it alone might not require a denial of the exemption. But further principles must be considered. There is strong evidence that in the several Articles whose primary aim was to achieve substantial equality of tax treatment as between nationals of the contracting parties, the mutual concessions made were clearly delimited within the four corners of the instrument. Where it was necessary to make adjustments in domestic provisions in order to achieve the objectives of the Article, these were made explicitly. Thus to sanction freewheeling adjustment of domestic provisions to achieve point-by-point equality would be to risk undoing the bargain reached by the two nations.”

In *Maximov* Justice Goldberg delivered the opinion of the Supreme Court. He held (10 L ed 2d 188): “... the petitioner asserts that equality of tax treatment was the objective of the treaty and that furtherance of this objective compels adoption of its theory that exemption must be accorded whenever the burden of the tax would diminish such equality. Since, in general terms at least, the UK imposes no tax on capital gains, says the petitioner, no similar tax should be imposed by the US here.”

Justice Goldberg continued later (10 L ed 2d 188 and 189, italics added, Footnote 2 omitted): “... there is no indication that application of the words of the treaty according to their obvious meaning effects a result inconsistent with the intent or expectations of its signatories. It appears from the relevant materials instructive as to the intent of the parties to the Convention that *the general purpose of the treaty was not to assure complete and strict equality of tax treatment – a virtually impossible task in light of the different tax structures of the two nations* – but rather, as appears from the preamble to the Convention itself, to facilitate commercial exchange through elimination of double taxation resulting from both countries levying on the same transaction or profit; an additional purpose was the prevention of fiscal evasion. Certainly, neither of these purposes requires the granting of relief in the situation here presented. There is concededly no imposition of a double tax on the gains of the petitioner, since neither it nor its beneficiaries are taxed thereon under UK law.”

Justice Goldberg continued later (10 L ed 2d 189, Footnote 3 omitted): “Even to the extent that one purpose of the Convention was to secure a measure of equality of tax treatment, it is apparent from the face of the treaty itself that no invariable or inflexible equality was sought or intended. In fact, the treaty creates some inequalities of treatment. ... To the extent that complete equality was intended, it was specifically provided. We cannot, in such a context, read the treaty to accord unintended benefits inconsistent with its words and not compellingly indicated by its implications. To say

that we should give a broad and efficacious scope to a treaty does not mean that we must sweep within the Convention what are legally and traditionally recognized to be domestic taxpayers not clearly within its protections; ...”

Goldberg J. concluded (10 L ed 2d 189 and 190): “Our interpretation affords every benefit negotiated for by the parties to the Convention on behalf of their respective residents and prevents an unintended windfall to a private party.”

Some US judges have cited the above judgments in *Maximov* as support for their (hopefully discredited) views that the intentions of the treaty partners should overrule the literal meaning of treaty words – see Chapter 6, notably Chapter 6.06.

12.04 US: August 25 1982 *Brown & Williamson* (Article 29); reciprocity and equality

American Trust and *Maximov* show that inequality of effect may occur when one State imposes a tax which the other State does not impose. A similar unequal effect may arise when one State grants tax relief when the other State does not.

In *Brown & Williamson*, the US granted interest on a tax refund – but the UK did not (though see UK: April 12 1991 *Commerzbank* – Article 24 and Chapter 12.13). Because the UK did not grant interest on tax refunds, should “reciprocity” and “equality” of tax treatment or effect preclude a UK resident from claiming interest on a US tax refund?

Senior Judge Skelton (in a dissenting opinion) applied the “equality” and “reciprocity” theories expounded by Orr J. in *American Trust* – even though the Supreme Court had effectively overruled them in *Maximov*. He summarised *American Trust* (688 F.2d 764 and 765): “The treaty did not mention trusts by name. The IRS contended that domestic laws of the US should be applied which would deny the exemption to the trust. The court held on the grounds of reciprocity that the exemption did apply to the trust and that the domestic laws of the US to the contrary did not apply. The facts showed that the UK does not impose an income tax on capital gains. The court reasoned that because of this fact a citizen resident in the US who realized a capital gain on the sale of a capital asset in the UK would not have to pay a capital gains tax, and that on the policy of reciprocity a citizen (the trust) of the UK similarly situated with respect to capital gains realized on a sale of a capital asset in the US should not have to pay a tax under our domestic tax laws. The court said that the purpose of the treaty was to “secure reciprocity and equality of tax treatments between the nationals of the two contracting parties.” The court went on to say there was no occasion for an express concession by the UK in the treaty with respect to trusts, because it does not impose an income tax on capital gains in any event.”

Senior Judge Skelton held that comparable issues arose in *Brown & Williamson* – where the plaintiff’s US subsidiaries had withheld US tax at 15% on dividends paid to its UK parent in 1975-78. The 1975 UK tax treaty reduced this withholding tax to 5% and, although it only came into force in 1980, it applied retroactively – effective 1975. The plaintiff obtained a refund of almost \$17.5m, representing the difference between the 15% and 5% rates. It then sought interest on this refund.

After repeating Orr J.'s (overruled) comments above in *American Trust*, Senior Judge Skelton commented (688 F.2d 765): "Applying the principles of that case [*American Trust*] to the one before us, it is clear that our decision should be made on the basis of reciprocity and equal tax treatment of the citizens of both countries. In our case, the Treaty is silent on the question of interest on tax refunds, but like in [*American Trust*] that is of no consequence, because under the laws of the UK interest is not paid on tax refunds. Therefore, like in [*American Trust*], there was no need for a provision on this point to be included in the Treaty. It is clear that under the Treaty involved here, if a US citizen gets a tax refund from the UK he could not collect interest on the refund. On the basis of reciprocity (and [*American Trust*]) a citizen of the UK, such as the plaintiff in the instant case, who gets a tax refund from the US should not be able to collect interest on the refunded taxes. To hold otherwise places an economic burden on citizens of the US as compared to citizens of the UK similarly situated. Obviously, the framers of the Treaty and the governments which ratified it did not intend to discriminate between the citizens of the two countries, nor to create a windfall for citizens of the UK, such as the plaintiff and others who may have similar claims, when such benefits are denied to citizens of the US who are in a similar situation. Therefore, the plaintiff's claim should be denied on the basis of reciprocity."

Nevertheless, the majority in *Brown & Williamson* held that interest was payable under US domestic law as from the date that withholding tax (which subsequently became excess) had originally been paid. The majority did not discuss the issue of reciprocity or *American Trust*.

12.05 Canada: equality of effect is not a tax treaty purpose

Canada: May 23 1963 *Mathewson* (Article 23) is further support for the proposition that it is not one of a tax treaty's purposes to ensure equality of tax treatment or effect. It holds that the fact that one State does not match a tax break available in the treaty partner State does not amount to double taxation.

Mathewson involved a US citizen resident in Canada who was a shareholder in a US corporation. He elected (under Subchapter S of the US Internal Revenue Code) to have this corporation treated as a partnership. This election enabled him to deduct losses made by this corporation for US tax purposes. He argued that he should also be able to deduct this loss for Canadian income tax purposes – even though Canadian tax law contained no provisions permitting a corporation to be treated as a partnership. This, he argued, was consistent with the 1942 US tax treaty's intent – that he be treated "on an equitable basis so as not to result in hardship".

W.S. Fisher Q.C. dismissed his appeal, holding (63 DTC 493): "... it is trite law, and long since well established, that there is no equity in a taxation statute, and this is particularly true where a taxpayer becomes liable for income tax under the provisions of the laws of two separate and distinct countries where, under the special provisions of their respective laws, tax is calculated and imposed on a different basis in each of the said countries. There are other differences in the taxes imposed on income in the US

and in Canada. For example, in the US there is a capital gains tax. A resident of Canada who happens to be a citizen of the US and is called upon to pay tax in the latter country in respect of income arising from sources therein, including tax on capital gains, is not subject in Canada to tax on those capital gains, nor will he be permitted a foreign tax credit, for Canadian tax purposes, in respect of any portion of his US income tax that was imposed in respect of capital gains.

... for the purposes of the Canadian income tax law, that [Subchapter S] company is a separate and distinct entity from either the taxpayer or his co-shareholder and therefore cannot be treated as a partnership, irrespective of any election by the company's shareholders to have it so treated under the provisions of the *Internal Revenue Code* of the US. The Board finds, also, that there is no provision in the Canada-US Tax Convention under which any relief can be afforded to the appellant."

12.06 A tax treaty provision may have an unequal effect

When State A imposes a tax which the other State B does not impose (the situation contemplated above by W.S. Fisher Q.C. in *Mathewson*) a tax treaty may seek to limit the application of this tax – and thus increase the chances of equality of effect. Nevertheless, even though this tax only exists in State A, the tax treaty will typically still be expressed in reciprocal terms – so that if and when the other treaty signatory State B does introduce such a tax, this treaty will also limit its application in State B.

Similarly, States may include a provision in a tax treaty to negate the application of a feature of State A's tax law which is only present in State A. If, as is usual, this provision is expressed in reciprocal terms, it will only become reciprocal in effect when State B subsequently enacts a comparable feature.

The fact that a reciprocally-expressed tax treaty provision may only have effect in one State does not rob this provision of any of its force.

In Canada: January 28 1985 *Gladden Estate* (Article 13 and see Chapter 9.16) US estate tax, and Canadian *income* tax on a deemed capital gain, were both payable on the death in 1977 of a US citizen and resident who owned Canadian shares.

Article VIII of the 1942 US tax treaty began: "Gains derived in one of the Contracting States from the sale or exchange of capital assets by a resident or a corporation or other entity of the other contracting State shall be exempt from taxation in the former State ... " The words "sale or exchange" appeared in Article VIII because they reflected the basis on which the US taxed capital gains in 1942 – when this treaty was concluded. At this time capital gains were not taxed in Canada.

Twenty eight years after the 1942 US tax treaty was concluded, Canada enacted s.70(5) Income Tax Act 1970 – which deemed a deceased person to dispose of all his Canadian property immediately before death. Such a disposal could generate a deemed "capital" gain – which s.70(5) taxed as income. The Estate argued (84 DTC 1245) that if s.70(5) applied, Article VIII should protect it – "for the simple reason that the primary purpose of the treaty was to avoid double taxation".

The Trial Division (reversing the Tax Court) held that there was no need to determine

the issue of whether double taxation arose because, as Addy J. held (85 DTC 5192): "... on a simple reading of Article VIII, it seems evident that double taxation is neither a condition nor a prerequisite for invoking the protection of a treaty. The non-resident can benefit from the exemption regardless of whether or not he is taxable on that capital gain in his own country. If Canada or the US were to abolish capital gains completely, while the other country did not, a resident of the country which had abolished capital gains would still be exempt from capital gains in the other country. This in effect was the situation between the time the treaty took effect and Canada in fact first imposed a capital gains tax. During that first period Canadians could benefit from Article VIII."

Addy J.'s statement makes it clear that even if one State abolishes a tax covered by a tax treaty Article, its residents can still claim the benefits of this Article as regards a (comparable) tax which the treaty partner State may still impose. A tax treaty thus remains in force irrespective of any inequality of effect which may exist at the time a tax treaty is concluded – or which may occur later.

However, a contrary view seems to have been taken in France: March 4 1993 Reply de Cuttoli (Article 13). This Reply runs in part (*italics added*): "On March 16 1951 France concluded with Canada a convention for the avoidance of double taxation on inheritance taxes on death, which provides for the imputation of tax levied in one State on the tax due in the other. Nevertheless Canada has since abolished, both at a federal and at a provincial level, taxes on transfers by way of gift.

However, Canada levies income tax on the latent capital gains on a deceased's estate calculated on the date of his death. Accordingly, the dispositions of *the* March 16 1951 Franco-Canadian *tax treaty can no longer apply. Estate taxes are due in France in accordance with the conditions contained in Article 750 ter onwards of the code général des impôts*, with Canadian income tax not being imputable. Similarly, French estate taxes cannot be used as a deduction from income tax due in Canada."

One implication of the words *italicised* above is that, since this 1951 Canada estate tax treaty "can no longer apply", French estate taxes are due solely in accordance with French domestic law – irrespective of the terms of this treaty. This implication is misleading. The holding that the 1951 Canada estate tax treaty "can no longer apply", because Canada has abolished gift and estate taxes, should only be interpreted to mean that it does not *need* to apply to avoid Canadian taxes which no longer exist. Despite the abolition of these Canadian taxes, this estate tax treaty will subsist until terminated – an event which has not occurred. The fact that Canada has abolished the very taxes which this treaty seeks to prevent from being levied twice does not mean that France can then levy taxes, under its domestic law, in situations not permitted by this treaty.

However (as March 4 1993 Reply de Cuttoli points out) double taxation may now arise because Canada now levies an *income* tax, and not an *estate* tax, on death.

Germany: *April 24 1975 BFH* (Article 6) also holds that a tax treaty provision which is reciprocal in form may only have an effect in one State. It holds that although Article IX(2) of the 1954 US tax treaty could have an effect as regards US tax, it could have

no effect as regards German tax. Although it could be invoked by a German resident investing in US real property, it could not be invoked by a US resident investing in German real property.

Article IX(2) permitted a resident of one State to “elect for any taxable year to compute tax on such income [from real property] on a net basis at the tax rates that would apply to a resident ... of the [other] contracting State in which the property is situated.” US tax law permits nonresidents to elect to be taxed on real property income on a net basis in the same way as a resident, so Article IX(2) clearly applied to a German resident owning US real property. However, nonresidents of Germany are, in any event, only taxable in Germany on net German real property income – but at a minimum 25% tax rate. In the light of this, could a US resident owning German real property invoke Article IX(2) – and seek to be taxed at rates which, under German domestic law, could only apply to a resident of Germany?

April 24 1975 BFH holds that the Article IX(2) net election was meaningless as regards Germany – where real property income was taxed on a net basis in any event. Accordingly, it dismissed the US resident’s claim to be taxed at rates which, under German domestic law, could only apply to a resident of Germany.

US: October 22 1975 *Burbank* (Article 26) also holds that a treaty does not cease to be obligatory just because an obligation is not reciprocal – see Chapter 13.03.

12.07 A tax treaty may have an unanticipated effect

Germany: *January 27 1988 BFH* (Article 10) also illustrates that a tax treaty may continue to apply even after a change in the situation which the parties had originally intended it to cover. The 1954 US tax treaty (as amended in 1965) imposed a reinvestment penalty, in the form of a 25% withholding tax, on profits distributed by a German subsidiary to a US parent. This penalty had been prompted by the 36% difference between the (51%) tax rate on retained profits and the (15%) tax rate on distributed profits. The BFH held that this penalty should continue to apply even after this split rate system was replaced by an imputation system – which reduced the difference between the tax rates on retained and distributed profits to 20%. The “ordinary meaning” of the treaty words should be applied – even though the German domestic law which had originally led to these words being included in the tax treaty had radically changed, and even though this treaty therefore had an unanticipated effect.

The fact that treaty partner States may only intend a reciprocal provision to cover a feature in one State’s tax laws may not prevent it from applying in a wholly different situation – if the ordinary meaning of the treaty’s terms require such a result. UK: February 9 1990 *Commerzbank* and Germany: *October 9 1985 BFH* (both Article 7 and see Chapter 6.05) amply illustrate that tax treaties may have unanticipated effects – which may differ if the treaty is interpreted differently in different States.

12.08 Five UK decisions on whether tax treaties must apply reciprocally

The issue of whether tax treaty terms should apply reciprocally has received particular attention in five UK decisions – the first four of which involved the same Articles (II and XV) of the 1945 US tax treaty (as amended in 1966).

Article II(1)(g) ran in part (*italics added*): “(1) In this Convention, unless the context otherwise requires ... (g) The term “resident of the UK” means any person (*other than a citizen of the US or a US corporation*) who is resident in the UK for the purposes of UK tax and not resident in the US for the purposes of US tax.”

Article XV’s *first* sentence ran: “Dividends and interest paid by a corporation of one Contracting Party shall be exempt from tax by the other Contracting Party except where the recipient is a citizen, resident or corporation of that other Contracting Party.”

12.09 UK: June 23 1972 *Strathalmond* (Article 4)

Strathalmond held that Article II(1)(g) precluded a “citizen of the US” from ever being a “resident of the UK”. A US citizen, even if resident in the UK under UK domestic law, could not be a “resident of the UK” under the treaty – because Article II(1)(g) precluded a “citizen of the US” from ever being a “resident of the UK”. Obviously, an individual could not be a corporation of the UK.

Strathalmond also held that a “resident ... of that other Contracting Party” (the UK) in Article XV’s first sentence meant “a resident of the UK” as defined by Article II(1)(g). Accordingly, in the light of Article XV’s first sentence, dividends paid by a corporation of one Contracting Party (the US) were exempt from tax by the other Contracting Party (the UK) where the individual recipient was a US citizen – and not a citizen of the UK.

This literal approach, specifically commended by Mummery J. in UK: February 9 1990 *Commerzbank* (Article 7 and see Chapters 6.05 and 12.12), was marred by *Pennyquick V.-C.* ignoring the words “unless the context otherwise requires” at the beginning of Article II(1)(g) – see Chapter 7.12.

12.10 UK: March 12 1976 *Avery Jones* (Article 4)

Avery Jones involved facts comparable to those in *Strathalmond* – save that the US citizen (Mrs. Rowley) had married a British subject, and had therefore acquired the additional status of a citizen of the UK and Colonies. After Mrs. Rowley’s death, her administrator contended that because the phrase “citizen ... of that other Contracting Party” (the UK) in Article XV’s first sentence was unknown to UK law, this phrase could not be construed as referring to a British subject or a citizen of the UK and Colonies. Accordingly, he contended that Mrs. Rowley was not (also) a “citizen ... of that other Contracting Party” (the UK).

Walton J. rejected this argument. If any sensible meaning was to be attributed to the phrase “citizen ... of that other Contracting Party” (the UK) in Article XV’s first sentence, it had to include “a citizen of the UK and Colonies” or a British subject – such as Mrs. Rowley. Had Walton J. held otherwise, this phrase would have had no meaning whatsoever – an untenable position, as indicated in Chapter 6.03.

Walton J. commented that when Article XV's first sentence referred to "a citizen" of "that other Contracting Party", it was intended to be reciprocal – and did not refer solely to a US citizen (and not a British subject). He commented (51 T.C. 454): "It is, as Mr. Davenport correctly submitted, obvious that article XV is intended to be completely reciprocal. Nor do I consider the fact that it will not, as it works out, be so, because of the differing definitions of residence to which I have already alluded, really affects this point. It is interesting to observe that where provisions are intended, though basically reciprocal, to apply slightly differently because of differences between the two tax systems, they are expressly so referred to (for example, articles 11 and the new 14 [*sic*]). Hence, I have no doubt at all that when the draftsman drafted this article in this compendious form he must have intended every portion to apply formally to both Contracting Parties equally on the basis of reciprocity."

The *second* sentence of Article XV of the 1945 US tax treaty ran: "This exemption shall not apply if the corporation paying such dividend or interest is a resident of the other Contracting Party."

Walton J. also focused on this second sentence – and on whether *Strathalmond* had been correctly decided. He spotted that this second sentence might never have effect as regards UK taxes on dividends paid by a company incorporated in the US (albeit resident in the UK) – because Article II(1)(g) excludes a "US corporation" (i.e. one incorporated in the US) from the definition of a "resident of the UK".

Walton J. thought it obvious that Article XV was intended to apply reciprocally, and (incorrectly) thought that any interpretation which was inconsistent with such reciprocal application had to be wrong. For this reason, he cast doubt on Pennyquick V.-C.'s decision in *Strathalmond* – see Chapter 12.09.

Thus, in a passage which Goulding J. in *Exxon* (see Chapter 12.11) described (56 T.C. 251) as "highly *obiter* (if indeed there can be degrees of that quality)", Walton J. commented (51 T.C. 455): "... I should enter one caveat as to the decision of Pennyquick V.-C. in the *Strathalmond* case ... [What] disturbs me is that, if his decision be right, the manifest intention of this article that it should in formal terms apply equally to the reverse situation (however such application might, in the light of the definitions, work out) can never happen. For this purpose one's attention must be directed to the last [second] sentence thereof: "This exemption shall not apply if the corporation paying such dividend or interest is a resident of the other Contracting Party." Now, if the corporation making the payment were a US corporation, it could *never* be a "resident of the UK" (see article II(1)(g)). More generally, owing to the special definitions of residence, the intention obviously manifest in article XV that it should apply equally both ways can never be realised. If ever the correctness of this decision should have to be reconsidered, I think this factor should be borne in mind."

What Walton J. did not spot was that, were *Strathalmond* followed, not only would Article XV's second sentence never have effect as regards UK taxes, but it would never have effect as regards US taxes either – for two reasons. Firstly, Article XV's second sentence only sought to preserve a right to tax companies on the basis of their

management and control – a basis of taxation which does not exist in the US. Secondly, a company incorporated in the UK could not be a resident of the US. Although the treaty did not define a corporate resident of the US, and only used the terms “US corporation” or “corporation of the US”, Article II(1)(d) effectively defined such corporations as corporations created or organised under the laws of the US. As a result, only a corporation incorporated in the US could be a resident of the US.

Accordingly, were *Strathalmond* followed, Article XV’s second sentence could apply reciprocally (albeit negatively) – because it could never apply *either* as regards UK taxes *or* as regards US taxes.

12.11 UK: March 1 1982 Exxon (Article 4)

Exxon (see Chapter 6.04) involved Article XV’s second sentence – and precisely the situation described by Walton J. in *Avery Jones*. Esso Holding Co UK Inc (“Holdings”), a corporation organised under the laws of the State of Delaware, USA, was a “corporation of the US” under Articles II(1)(d) and II(1)(f) of the treaty. However, it was also resident in the UK under UK domestic law – because it was managed and controlled in the UK. Holdings paid substantial dividends to its parent (“Exxon”), a corporation organised under the laws of the State of New Jersey, USA. Exxon was also a “corporation of the US” – but it was not resident in the UK.

Exxon claimed that because it was not a citizen, resident or corporation of that other Contracting Party (the UK), the dividends paid to it by Holdings were exempt from tax by the other Contracting Party (the UK). Article XV’s second sentence did not apply because Holdings was not a resident of the other Contracting Party (the UK). Holdings could not be such a UK resident because it was a US corporation – which Article II(1)(g) excluded from the definition of a “resident of the UK”.

Strathalmond had held that the words “resident of that other Contracting Party” (the UK) in Article XV’s *first* sentence should be equated with the words “resident of the UK” in Article II(1)(g). Exxon argued that the words “resident of the other Contracting Party” (the UK) in Article XV’s *second* sentence should also be equated with the words “resident of the UK” in Article II(1)(g).

Goulding J. dismissed Exxon’s argument. However, he also held (56 T.C. 253): “I remain entirely unshaken in my conviction that the *Strathalmond* case was rightly decided ...”. He thus held, remarkably, that the virtually identical words in Article XV’s first and second sentences could mean different things. He held that Holdings was a “resident of the other Contracting Party” (the UK) within the meaning of Article XV’s *second* sentence – even though, implicitly, it was not a “resident of that other Contracting Party” (the UK) within the meaning of Article XV’s *first* sentence.

In *Exxon* it was accepted that Article XV’s second sentence could not have effect as regards US taxes, for the reasons given above. Exxon’s Counsel (Mr. Potter) therefore neatly allied himself with the very Judge who, in *Avery Jones*, had expressed reservations about *Strathalmond*. Mr. Potter stressed Walton J.’s comments in *Avery Jones* on the need for reciprocity – and pointed out that if *Strathalmond* was followed

Article XV's second sentence should not have any effect as regards UK taxes either.

Goulding J. rejected this "negative reciprocity" argument, commenting (56 T.C. 252 and 253): "It might be said in favour of Mr. Potter's submission that Walton J. in the *Avery Jones* ... case thought it obvious that Article XV was intended to apply both ways. Therefore, since it is now common ground that the second sentence cannot operate to deny exemption from US tax, it ought not to deny exemption from UK tax either. That, however, is an argument that might find more favour with a computer than with a judicial mind."

Goulding J. thus confirmed that although tax treaty terms may be intended to be reciprocal, they do not *have* to be interpreted as being reciprocal – either positively or negatively. This point remains valid even though, in common with *Pennyquick V.-C.* in *Strathalmond*, Goulding J. ignored (incorrectly – see Chapter 7.12) the words "unless the context otherwise requires" at the beginning of Article II(1)(g). Had he decided that the context required more suitable definitions to apply, he could have construed Article XV's first and second sentences as being (positively) reciprocal.

12.12 UK: February 9 1990 *Commerzbank* (Article 7)

Commerzbank (see Chapter 6.05) also involved Article XV of the 1945 US tax treaty – and, citing some of the quotations above, the Revenue based their first argument on reciprocity. Mummery J. refused to accept that the treaty had to have a reciprocal and equal effect in each State. He commented ([1990] STC 299g): "The first argument of the Crown is based on reciprocity. The submission is that, in amending the 1946 version of art XV, the governments of the USA and the UK intended that the waiver of the right to tax interest and dividends in the stated circumstances should not be interpreted so as to have greater effect in the UK than in the USA. This argument involves looking back to the domestic law of the USA before the convention was made and its relation to both the original and the amended form of Article XV."

After referring to *Exxon* (Chapter 12.11) Mummery J. held ([1990] STC 300h): "Reliance was placed on ... [*Avery Jones* ... at 51 T.C. 454] for the proposition that art XV was intended to be reciprocal and have equal effect on the tax systems of both countries. It was accepted, however, that the decision in ... [*Strathalmond*] ... showed that a relieving provision in art XV could have an effect in UK tax law without having an reciprocal effect in US tax law. Reciprocity is an ideal to which the convention aspires but may fail to achieve in all cases."

12.13 UK: April 12 1991 *Commerzbank* (Article 24)

In this second *Commerzbank* decision, the UK High Court again accepted that a tax treaty provision that is reciprocal in form may not have effect in one State. *Commerzbank* argued that a denial of a repayment supplement (interest) on the sum awarded to it by February 9 1990 *Commerzbank* (Chapter 12.12) amounted to discrimination of a type precluded by Article XX(1) of the 1964 Germany tax treaty.

Article XX(1) runs: "(1) The nationals of one of the Contracting States shall not be

subject in the other State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected.”

The (third) Revenue argument was that there was no basis on which Commerzbank could allege discrimination on the ground of nationality – because it was subject to UK tax on the basis of residence (only). The Revenue argued (in Nolan L.J.’s words, [1991] STC 277) “... that the comparison required by art XX(1) is a comparison between German and UK nationals in the same circumstances. The bank is a German national as defined by art XX(2) because it is a legal person deriving its status as such from the law in force in the Federal Republic of Germany and so its taxation treatment must be compared with that of a company which is a UK national, that is to say, a company which derives its status as a legal person from the laws in force in the UK. But the comparison is meaningless because UK tax law in general, and corporation tax in particular, does not depend upon nationality, nor upon the law from which a legal person derives its status: it depends upon residence. Thus, a company deriving its status from the laws of the UK, which was resident in the Federal Republic of Germany, and which traded through a branch in the UK would be treated for tax purposes in precisely the same manner as the bank. Consequently, there is no basis upon which the bank can allege discrimination on the ground of nationality.”

As Nolan L.J. confirmed ([1991] STC 277): “It is fair to say that counsel for the Crown did not put this argument in the forefront of his case. It leads to the unattractive conclusion that art XX(1) is of no assistance whatever to German companies, partnerships or associations.”

However unattractive this conclusion may be, a comparable conclusion had been reached in UK: February 9 1990 *Commerzbank* (see Chapter 12.12) in relation to Article XV of the 1945 US tax treaty. No doubt mindful of this, Nolan L.J. continued ([1991] STC 277 and 278): “It is not uncommon, however, for provisions in double tax conventions to operate solely for the benefit of one party, with no compensating advantage to the other. Article XV of the UK/US convention, the article by which the bank has established its entitlement to exemption from UK tax on US interest, has a similar effect, though in that case it is the UK which is the loser. Accordingly there is some poetic justice in the comment which counsel for the Crown makes upon this and other aspects of the case to the effect that the bank cannot have it both ways.”

However poetic one might wish justice to be, *July 13 1993 ECJ* held that Commerzbank had been discriminated against in contravention of EU law. This decision will lift the scales from the eyes of those who have ignored the fact that EU non-discrimination provisions can be far wider than tax treaty non-discrimination provisions – as forecast in the *Editorial in The International Tax Treaties Service on France: November 18 1985 CE* (Article 24). By confirming that EU laws protected Commerzbank from discrimination, even though it had reaped tax treaty benefits, *July 13 1993 ECJ* implicitly confirms that tax treaties can have results which are contrary to the intentions of the treaty partner States – see Chapter 6.

Chapter 13 Reciprocity, unequal effects and the exchange of information

13.01 Reciprocity and the exchange of information

Just as tax exemptions have historically been conditional upon reciprocity (see Chapter 12.01), so it has long been accepted that tax enforcement remedies (see Chapter 11.05) may also be conditional upon reciprocity.

Thus, US: March 23 1979 *Gilbertson* (Article 26 and see Chapter 11.05) held that because the Supreme Court of Canada in *Harden* had refused to enforce the US Government's suit (which did not involve a tax treaty) on a judgment for income tax liability entered by a Federal Court in California, the US should refuse to enforce a judgment for taxes due to the Canadian Province of British Columbia. Blaine Anderson J. commented (597 F.2d 1166) that reciprocity "... certainly remains a factor which may be considered in deciding whether to recognise a foreign country's judgment for taxes ... Reciprocity would itself be a sufficient basis for denying British Columbia's claim. The courts of British Columbia, relying upon the revenue rule, have refused to recognise the judgment of a US court for taxes. *US v. Harden* 1963 Canada Law Reports 366 (Sup. Ct. of Canada, 1963, *affirming* Court of Appeal for British Columbia)."

The Commentary on Article 26 of the 1977 OECD Model also stresses that the *exchange* of information is meant to be reciprocal. Para. 1 notes that Contracting States have a growing interest in the reciprocal supply of information, and Para. 11 refers to "Reciprocal assistance between tax administrations ...". Both Paras. are identical in the 1992 OECD Commentary.

Some tax treaties are expressly conditional on reciprocity (see Chapter 5.02) – as are some exchange of information Articles in tax treaties. For example, Article 21 of the 1964 Belgium/France tax treaty is expressly conditional on reciprocity – see Belgium: *October 29 1984 Courtrai Court* (Article 26).

Nevertheless, it is often the case that, as Para. 18 of the Commentary on Article 26 of the 1977 and 1992 OECD Models notes: "... the structure of the information systems of two Contracting States is very different ...". This may lead to more information being exchanged, or exchangeable, by one State than by its treaty partner State. This, in turn, will lead to a lack of reciprocity and unequal effects, as discussed below.

Article 26(1) of the 1977 and 1992 OECD Models authorises competent authorities to *exchange* "such information as is necessary for carrying out the provisions of this Convention or of the domestic laws of the Contracting States concerning taxes covered by the Convention ...".

Article 26(2) of the 1977 and 1992 OECD Models begins (some italics added): "2. In no case shall the provisions of paragraph 1 be construed so as to impose on a Contracting State *the obligation: a)* to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State, ..."

Clearly, information can be obtained (under Article 26(2)(a)) and supplied (under Article 26(2)(b)) if this would not conflict with the laws of either the requesting or the requested State. Equally clearly, information cannot be obtained nor supplied if this would conflict with the laws of both the requesting and the requested States. In both cases, Article 26 will operate reciprocally – albeit, in the latter case, in a negative sense.

Two other possibilities remain: the obtention and supply of information by the requested state may conflict with the laws of the requesting State (only) – or the obtention and supply of information may conflict with the laws of the requested State (only). These two possibilities may involve a treaty having an unequal effect in each State – and a lack of reciprocity. For example State A, which permits information to be obtained by a treaty partner State (B), may, in a *reverse* situation, be precluded from obtaining similar information from B. These possibilities, and the implications of their reverse situations, are examined below – always from the perspective of the requested State.

13.02 *The position in a requested State (A) if the laws of the requesting State (B) do not permit B to obtain the information B requests*

Para. 15 of the Commentary on Article 26(2) of the 1977 and 1992 OECD Models provides: “... the requested State does not need to go so far as to carry out administrative measures that are not permitted under the laws or practice of the requesting State or to supply items of information that are not obtainable under the laws or in the normal course of administration of the requesting State.”

Para. 15 then continues (inaccurately): “It follows that a Contracting State cannot take advantage of the information system of the other Contracting State if it is wider than its own system.” This sentence gives the strong impression that when the laws of the requesting State do not permit information to be obtained, a requested State cannot use its own (wider) laws to obtain and supply such information. Baker reads Article 26(2) in this way, describing it (1991, 346 and 1994, 444, italics added) as: “... a lowest common denominator provision – information can *only* be exchanged if obtainable under the laws, administrative measures, and in the normal course of administration of *both* states.”

However, Para. 17 of this Commentary may interpret Article 26(2) more accurately. It starts (italics added): “17. The requested State is *at liberty* to refuse to give information in the cases referred to in the *paragraphs* above. However *if it does give the requested information, it remains within the framework of the agreement* on the exchange of information which is laid down in the Convention; consequently it cannot be objected that this State has failed to observe the obligation to secrecy.”

The italicised words in Para. 17 imply that although a requested State (A) need not obtain and supply information which would not be obtainable under the laws of the requesting State (B), it is nevertheless at liberty to do so. If it does so, the treaty will probably not be applied reciprocally – because, were the situation reversed, B’s laws

would probably preclude B from obtaining, and supplying to A, information which B could not itself obtain. This reverse situation is examined in Chapter 13.03.

Despite Para. 17, and a provision in the 1971 Norway tax treaty which is virtually identical to Article 26(2) of the 1977 OECD Model, US: February 14 1980 *Lincoln First Bank* (Article 26) holds that the US is precluded from using its own laws to obtain and supply information which would not be obtainable under the laws of the requesting State (Norway). Although Pierce D.J. quoted an extract from Para. 15 of the Commentary on Article 26 of the 1977 OECD Model, he did not quote Para. 17 of this Commentary – perhaps because he felt that the US should not exercise any discretion which Para. 17 might grant it.

To understand *Lincoln First Bank*, one must appreciate that enforcement of a summons will be denied in the US when a US tax investigation has reached the stage of a US criminal prosecution. In *Lincoln First Bank* the IRS argued that so long as no US criminal prosecution had been recommended, an IRS summons at Norway's request should be enforced – even though a Norwegian criminal prosecution was under way.

Pierce D.J. commented (80-1 USTC 83,405): “Assuming arguendo that this construction is correct, petitioners have not yet shown that enforcement of the summons would otherwise not be inconsistent with the laws and administrative practices of Norway under these particular circumstances. Under the treaty, the US is not obliged to and, in the opinion of this Court should not take measures which are inconsistent with Norwegian law in an effort to comply with the request for information. As noted in ... [US: October 22 1975 *Burbank* – Article 26 and see Chapter 13.03] ... which quotes from the 1975 Revised Commentary to the Model Treaty upon which the treaty in controversy herein was apparently patterned, the requesting party (Norway) may not take advantage of the information system of the other party (US) if it is wider than the information system of the requesting party.

Petitioners nonetheless contend that although the treaty does not oblige the US to take measures which are not authorized under Norwegian law or to supply information which could not be obtained thereunder, the US may take such measures or supply such information. The treaty, it is argued, merely establishes the minimum obligations of the US and does not limit the measures it may take. They therefore conclude that the IRS may supply the information requested regardless of and without a showing of applicable Norwegian law.

The Court does not find this unsupported argument persuasive. The governmental Agencies of the US should not be employed to provide information to a foreign country which could not be obtained under the laws of that country. A holding to the contrary could result in an unintended circumvention of applicable foreign laws and related domestic laws. Therefore, absent express authority which supports the petitioners' position, this Court finds that their application must be denied since they have not shown that enforcement of the summons would not be inconsistent with Norwegian law under the circumstances herein. Proof of such consistency shall be part of petitioners' burden of demonstrating that the summons was issued for a legitimate

purpose since it is undisputed that the summons could not be issued in furtherance of a domestic tax investigation under the circumstances presented here.”

Since *Lincoln First Bank*, US tax authorities typically aver that the information sought by a requesting State is obtainable under this State’s laws. Thus in US: December 15 1982 *Bache* (Article 26) the IRS affidavit swore that the agent was the competent authority in the US for administering requests by treaty partners, that he had determined that the Netherlands’ request was within the Convention, that the requested information might be relevant to a determination of the correct tax liability of the petitioner under Netherlands law, that the request was issued in the course of a civil tax investigation by Netherlands tax authorities, and that *the same type of information could be obtained by tax authorities under the law of the Netherlands*.

Similarly, in US: November 27 1991 *Panton* (Article 26) the IRS affidavit ran in part (780 F.Supp. 801, Footnote 5, italics added): “5. I am satisfied that the requested information is not within the possession of the Internal Revenue Service or the Jamaican tax authorities; that the requested information as it relates to Mr. Panton may be relevant to a determination of the correct liability of Mr. Panton under Jamaican law; and that *the same type of information can be obtained by the tax authorities under Jamaican law*.”

However, in Canada: July 4 1991 *Montreal Aluminium* (Article 26) the Trial Division seemingly permitted the Canadian tax authorities to aid the US tax authorities in overcoming or by-passing a restraint placed upon them under US domestic law.

The US Secretary of the Treasury had requested information concerning the Plaintiff company from the Canadian Minister of National Revenue – who issued a Requirement (which was arguably incorrect, as indicated below) requesting this information.

Part of the plaintiff’s (third) argument was based on Article XXVII(3) of the 1980 US tax treaty. This provides that Article XXVII should not be construed as imposing on Canada the obligation to supply information not obtainable either under the laws of Canada or *under the laws of the US*.

The plaintiff argued (in Joyal J.’s words – 91 DTC 5426): “... that the *Tax Convention Act* itself does not alter domestic law or give the Minister the power to issue an otherwise invalid Requirement for information, in order to enforce compliance with US taxation laws.”

As Joyal J. commented (91 DTC 5428): “According to counsel for the plaintiff, the compulsory acquisition of the information and documents sought would be at variance with both Canadian and US law and administrative practice because the US Secretary of the Treasury wants the information for use in connection with Grand Jury proceedings not solely related to the violation of US tax laws.”

Paragraph 6(a) of the plaintiff’s statement of claim read in part (91 DTC 5428, italics added): “... the information and documents required by the Requirement was information sought for use in connection with a US Grand Jury investigation into *alleged violations of US laws other than tax laws* as well as alleged violations of US tax laws and such information, not only does not fall within paragraph 1 of Article

XXVII but, is not information obtainable compulsorily under the laws, or in the normal course of the administration, of the US and the Requirement thereof is at variance with the laws and administrative practice of the US; ...”

The plaintiff’s fourth argument was that even if the Minister did have power to require information in this case then, in Joyal J.’s words (91 DTC 5426): “... it would have to be limited to information related to the domestic laws of the US *concerning taxes* and that the information requested in this case extended to matters beyond compliance with tax laws. He also argued that the Requirement was not issued pursuant to the *Tax Convention Act*, but rather was an *ultra vires* attempt by the Minister to exercise his powers under s. 231.2 of the *Income Tax Act*.”

Joyal J. dismissed simultaneously the plaintiff’s arguments that the US tax authorities themselves would not be able to obtain the information requested, and that the request would have to be limited to information related to US domestic taxes. He held (91 DTC 5429): “As to the US position, the fact disclosed in paragraph 6(a) of the statement of claim is that such information is not obtainable by reason of the Grand Jury inquiry. If that is so, the information would not be admissible for that purpose and would only, therefore, be admissible for tax law purposes which, after all, is the main thrust and purpose of the Convention.

Furthermore, I must refer again to the terms of Article XXVII of the Convention itself. This Article clearly indicates that US tax authorities possess a means of obtaining information from American residents regarding tax administration and enforcement matters, which is similar to our procedure under s. 231.2.

Also, it is clear upon reading paragraph 1 of Article XXVII, that the information received by the US is to be treated as secret and is to be used only for the purpose of administering and enforcing taxes covered by the Convention. That undertaking, mutually binding on the Contracting States, is of a nature to suggest mutual respect of it. I conclude therefore that although an investigation may also be carried out with respect to alleged violations of other US laws, this Court has no reason to believe that the information provided to the Secretary of the Treasury will be used otherwise than in accordance with the terms of Article XXVII of the Convention, pursuant to which the information is given.”

By permitting the information to be obtained and passed on to the US tax authorities, Joyal J. permitted the US tax authorities to obtain indirectly what they were most probably precluded from obtaining directly under US domestic law.

In permitting this treaty-shopping by the US tax authorities, Joyal J. also ignored the issue of reciprocity – i.e. whether the US courts would allow the US tax authorities to obtain and pass on information to a treaty partner State’s tax authorities which they were unable to obtain under this treaty partner State’s domestic laws.

In US: February 14 1980 *Lincoln First Bank* (Article 26 and above) Pierce J. held that US governmental agencies should not be employed to provide information to a foreign country which could not be obtained under the laws of that country. Accordingly, when seeking to justify the validity of a summons, an IRS official

typically submits an affidavit that, inter alia, “the same type of information can be obtained by tax authorities under the law of” the requesting State – as US: December 15 1982 *Bache* and November 27 1991 *Panton* both evidence (both Article 26 and above).

Furthermore, Article XXVII(1) only permits the exchange of “such information as is necessary for carrying out ... the domestic laws of the ... [US] ... concerning taxes covered by the Convention ...” Joyal J.’s holding (91 DTC 5429): “... this Court has no reason to believe that the information ... will be used otherwise than in accordance with the terms of Article XXVII” is, in view of the Plaintiffs’ assertion to the contrary, unconvincing. Instead of investigating how the information would be used, so as to ensure that Article XXVII(1) was satisfied, Joyal J. simply accepted that US law would preclude the use of such information for non-tax (i.e. Grand Jury) purposes. In other words, Joyal J. felt that it should be left to the US legal process to give the Plaintiffs such protection as Article XXVII afforded them. This comes close to an abdication of Canadian judicial responsibility.

13.03 *The position in the requested State if, were it to request information in a reverse situation to the one at issue (i.e. where its tax is at stake), the other State’s laws would not permit this other State to obtain this information*

This reverse situation becomes clearer once it is appreciated that State A’s laws regarding what information may be obtained may be more restrictive than State B’s laws.

For example, the domestic laws of (a requested) State A may only permit its tax authorities to obtain information if its own domestic State A tax is at stake – and State B’s laws may not contain such a restriction.

Similarly, State A’s secrecy or public policy rules precluding it from exchanging information may be more stringent than those in its treaty partner State B. Article 26(2)(c) of the 1977 and 1992 OECD Models provides that a requested State has no obligation “(c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (*ordre public*)”.

An example of State A’s laws which preclude it from complying with a request for information by State B which relates only to State B’s taxes is contained in a (new) Observation in Para. 22 of the Commentary on Article 26 of the 1992 OECD Model which runs: “22. The *UK* takes the view that the Article imposes no obligation on it to carry out enquiries on behalf of a Contracting State in cases where no liability to UK tax is at issue, since to carry out such enquiries would be contrary to its laws and administrative practice (cf. the last sentence of paragraph 16 above).”

This last sentence in Para. 16 is the same in the 1977 and 1992 OECD Models. It runs in part (*italics added*): “... the requested State has to collect the information the other State needs *in the same way as if its own taxation was involved* ...” These italicised words are identical to those in Article XVII(3) of the 1980 US tax treaty at issue in

Canada: July 4 1991 *Montreal Aluminium* (Chapter 13.02).

The UK view in Para. 22 reflects the fact that, under the UK Taxes Management Act 1970, the only information which may generally be obtained is information which is relevant to UK tax. That this is the general position is confirmed by the fact the UK had to enact specific legislation (s.125 Finance Act 1990) to enable it to comply with its exchange of information obligations as regards direct taxation under the EC Directive of December 19 1977. s.125 extends the range of information which can be obtained in the UK to include any information relevant to direct tax in any EC Member State. Bartlett (an official in the UK Inland Revenue) has commented (1990, 82): "... partner countries are made aware of this limitation when agreements are negotiated."

In contrast, US: April 20 1994 *Barquero* (Article 26) involves Article 4(5) of the Mexico TIEA. Article 4(5) provides, in edited form, "[I]f information is requested by a Contracting State (Mexico) pursuant to paragraph 4, the requested State (US) shall obtain the information requested in the same manner, and provide it in the same form, as if the tax of the applicant State were the tax of the requested State and were being imposed by the requested State."

In the District Court Judge Vela (citing US: February 28 1989 *Stuart* – Article 26 and Chapter 13.05) held: "Clearly, the IRS has the authority to use its summons power for domestic investigations. Since this Court has held that the TIEA is valid, its provisions must be given effect. In this case, that includes allowing the IRS to use its summons power to retrieve documents that are central to the Mexican government's request as if the I.R.S. was requesting the documents for its own investigation." Judge Vela's holding was upheld on appeal.

A State A law precluding State A from complying with a request from (a requesting) State B for information relating solely to State B's taxes will much restrict the operation of the Exchange of Information Articles in State A's tax treaties. Obviously, a State will normally only request information which involves its own taxes – because it will normally only be interested in its own taxes. It is, therefore, implicit in Article 26 that State B may request information from State A which relates solely to those State B taxes which are covered by the Convention.

That this is the normal interpretation of Article 26 is confirmed by the third sentence of Para. 14 of the Commentary on Article 26 of the 1977 and 1992 OECD Models. This sentence runs in part (*italics added*): "... types of administrative measures authorised for the purpose of the requested State's tax must be utilised, *even though invoked solely to provide information to the other Contracting State.*"

Even if the laws of a State (such as State A) restrict the information which it may obtain in order to satisfy a request from a treaty partner State B, State B's laws may well not contain a comparable restriction. This may lead to an Exchange of Information Article operating with unequal effect – and unreciprocally.

For example, were the situation described in two paragraphs above reversed, with State A requesting information from State B, the treaty Article will operate unreciprocally if State B supplies information to State A – even though State A would

not supply such information to State B. In this event, should State B's courts interpret this Article so to narrow State B's laws – so that they match State A's laws? And, in the situation described three paragraphs above, should State A's courts interpret this Article so to broaden State A's laws – so that they match State B's laws?

The first question can be put another way: should State B be obliged to provide information to the requesting State A – even though State A would not honour a similar request by State B? This question arose in US: October 22 1975 *Burbank* (Article 26) when the Appellees pointed out that the Canadian tax authorities could only obtain (and therefore furnish) information when *Canadian* tax was at stake. (In the light of Canada: July 4 1991 *Montreal Aluminium* (see Chapters 13.02 and 13.04) this may no longer be the case.) They emphasised that, accordingly, an Internal Revenue Manual directed IRS agents to “[p]rovide adequate background to support a *Canadian* Tax interest” (italics added) when requesting information from the Canadian tax authorities. They argued that when there was no *US* tax interest (i.e. when no *US* tax was at stake, as in this case) the US tax authorities should be similarly precluded from obtaining information in the US.

In *Burbank*, Mulligan J. held (525 F.2d 15, footnotes omitted): “The Government concedes that this represents IRS's understanding of the Canadian position as the result of conversations between IRS representatives and the Canadian Ministry of National Revenue between 1960 and 1962. There is nothing in the record however to establish that this is the official Canadian construction of the Treaty but even on the assumption that it is, we do not consider it fatal to appellant's position here. It may represent the Canadian view but it does not represent the *American* interpretation. The Government states that the position it takes here, which has been approved by the Office of the Legal Adviser, Department of State, and the Office of International Tax Counsel, Treasury Department, constitutes the interpretation of the Treaty which the US has consistently maintained. The Government argues that there has been no prior litigation on this point precisely because that position has not been challenged before. Although the appellees are skeptical we see nothing in the record which would contradict this representation made by the Government in its brief and emphasized on the oral argument below.”

In *Burbank*, the Appellees then argued (525 F.2d 15, footnotes omitted): “... that even if the Manual interpretation represents just the Canadian position, if the Treaty purpose was to provide the exchange of information on a reciprocal basis, then the US should not now be under any greater obligation to furnish information than is the Canadian Government.” Mulligan J. held that even if a treaty obligation was not reciprocal (see Chapter 5), the treaty did not cease to be obligatory (see Chapter 12.06). Accordingly, he concluded (525 F.2d 15): “... the Canadian interpretation, even if it be at odds with that of the US, is not relevant here.”

Despite (or perhaps because of) his reliance upon 1974 OECD provisional Revised Commentary in interpreting a 1942 tax treaty (see Chapter 26.06), Mulligan J. held that this treaty had to be applied even if this did not result in an equal effect.

Article XIX of the 1942 tax Canada treaty at issue in *Burbank* provided that each State "... undertakes to furnish ... the information which its competent authorities ... are in a position to obtain under *its* revenue laws ..." (italics added). *Burbank* holds that Article XIX required the US to furnish the information which it can obtain under *its* revenue laws – and not that its revenue laws should be limited to only permit the obtention of such information as the other State's revenue laws would permit.

Burbank illustrates that a requested State (the US) can use its own laws to obtain and supply information even though, were the situation reversed, the requesting State (Canada) might not be able to obtain such information. Although *Burbank* involved the 1942 Canada tax treaty, which did not contain a provision comparable to Article 26(2) of the 1977 OECD Model (see above), its rationale would seem equally applicable to a treaty which does contain such a provision.

Burbank thus holds that a treaty provision may have a greater effect in one State than in another – with the US being under a greater obligation to furnish information than its treaty partner, Canada. "Reciprocity" does not require a State (the US) to narrow the powers available to its tax authorities under its tax laws so that they match those available to the treaty partner State's tax authorities under that State's tax laws.

In such circumstances, where the laws in two States do not match, a tax treaty may therefore not have an equal effect in each State and may not operate as a perfect reciprocal match.

If reciprocity does not require a State to narrow the operation of its tax laws so that they match the (narrower) tax laws of its treaty partner State, it would seem to follow that reciprocity cannot require a State to broaden the operation of its tax laws so that they match the (broader) tax laws of its treaty partner State. However, the position may not be quite as simple as this – as indicated in Chapters 13.04 and 13.05.

13.04 *The position in a requested State (A) if its laws do not permit it to obtain the requested information*

What if the obtention and supply of information is not permissible under the laws of the requested State? Put so simply, this question can be answered just as simply. If the laws of the requested State do not permit information to be obtained and/or supplied, that is the end of the matter – irrespective of whether the requesting State's laws are broader. But can a tax treaty broaden a (requested) State's domestic law – possibly to an extent dictated solely by the laws of a foreign (requesting) State? Can a tax treaty increase information-gathering powers – possibly solely as a result of a foreign State's laws (which may be amended at any time)?

Such a result has, arguably, been reached in Canada: July 4 1991 *Montreal Aluminium* (Article 26 and see Chapters 13.02 and 13.03) and in the US (see below) – even though it raises constitutional issues comparable to those raised by the possibility of a tax treaty imposing tax.

As indicated in Chapter 13.02, *Montreal Aluminium* holds (debatably) that even if the US could not, under its laws, obtain the information it requested, Canada should

comply with the US request. The Plaintiffs' second argument was that the only provision in Canadian law which conferred upon the Minister the power to obtain information was s.231.2(1) of the Income Tax Act – and s.231 only permits the Minister to require information for the purposes of *this Act*. No tax liability under this Act was in issue (i.e. no Canadian tax under the Income Tax Act was in issue). The only tax in issue was tax under the US Internal Revenue Code. Furthermore, Article XVII(2) of the 1980 US tax treaty provided that Canada had to endeavour to obtain the information requested “in the same way as if *its own* taxation were involved” (italics added). This meant that Canada could only invoke s.231.2(1) – which could not apply because no Canadian tax was at stake. In Joyal J.'s words (91 DTC 5426): “The Article does not stipulate that if a certain power is lacking under current domestic law then Canada shall proceed to enact new legislation compelling disclosure of information from Canadian residents, for purposes of the administration and enforcement of US taxation laws.”

The Defendants countered that, under s.3(2) of the Tax Convention Act (which brought this 1980 US tax treaty into force in Canada) the Convention was to prevail in the event of any inconsistency between it and the provisions of the Income Tax Act. Article XXVII, especially Paragraph 2, required a Contracting State to obtain information – and hence authorised the issue of the s.231.2 Requirement for the purposes of enforcing US tax law.

Joyal J. dismissed this second argument by the Plaintiffs, holding (91 DTC 5427): “Subsection 231.2(1) authorizes the Minister to serve a Requirement on any person for information or production of documents “for any purpose relating to the administration or enforcement of this Act”. If our analysis were to stop here, then clearly the plaintiffs would have good cause to contest the validity of the Requirement issued to Philip Klein on March 4, 1991. On the face of it, the Requirement was for the purposes of the US Internal Revenue Code and not for the purposes of the *Income Tax Act*.”

(The Plaintiffs then raised this very point in Canada: October 26 1992 *Montreal Aluminium* (Article 26) – which held that this Requirement, requesting information for purposes related to the administration of *Canada's* Income Tax Act, was incorrect and (arguably) misleading.)

Joyal J. continued (91 DTC 5427 and 5428): “However, if we proceed to examine Article XXVII of the Convention, paragraph 2 makes it quite clear that if information is requested by a Contracting State (in this case the US), then the other Contracting State (i.e. Canada) “shall endeavor to obtain the information to which the request relates *in the same way as if its own taxation was involved ...* ” In other words, if the US Secretary of the Treasury requests information from Canadian authorities, then the Minister of National Revenue is to obtain the information in exactly the same manner as if taxes under the Canadian *Income Tax Act* were involved. In my view, then, Article XXVII clearly foresees that the Minister will exercise his power under s. 231.2 of the *Income Tax Act* to issue a Requirement in these circumstances.

However, as counsel for the plaintiff correctly pointed out, a treaty to which Canada

is a signatory does not automatically become incorporated into our domestic law. Treaty obligations entailing an alteration of domestic law require legislative action: *A.G. Canada v. A.G. Ontario (Labour Conventions)*, [1937] A.C. 326 at 347-8.

In this particular case, a statute was enacted. Section 3 of the *Tax Convention Act* clearly states that the Convention has the force of law in Canada. More than this, however, the Convention is even said to prevail over other domestic law to the extent of any inconsistencies. The result, to my mind, is that the Minister does have the power to issue a Requirement under s. 231.2 in respect of information and documents requested by US authorities for tax purposes, in the same way he does with respect to information and documents required for Canadian tax purposes.

Essentially, the Convention provides that the Minister can take information otherwise obtainable for purposes of administration and enforcement of Canadian taxation law and pass that information along to American authorities for the additional purpose of administration and enforcement of US taxation law. Article XXVII of the Convention broadens the purposes for which information and documents obtained under s. 231.2 of the *Income Tax Act* may be used. Since Article XXVII has the force of law in Canada by virtue of the *Tax Convention Act*, the Minister has express legal authority to issue a Requirement under s. 231.2 for purposes of the administration and enforcement of US taxation law.

I suppose a different approach would be to say that to the extent s. 231.2 limits the use of such Requirements to the administration and enforcement of Canadian taxation law, it is inconsistent with Article XXVII of the Convention and by virtue of ss. 3(2) of the *Tax Convention Act*, the latter provision must prevail. In any event whatever the theoretical view-point adopted, the practical consequences are the same.”

One can criticise Joyal J.’s holding that Article XXVII effectively broadens s.231.2 of the *Income Tax Act* on both tax treaty and constitutional grounds.

As regards the tax treaty, Article XXVII(2) provides (*italics added*) that a Contracting State “... shall *endeavor* to obtain the information to which the request relates in the same way as if its own taxation was involved ...” It is arguable that Article XXVII(2) only requires Canada to *endeavor* to obtain information in the same way as if its own tax was involved – and does not *oblige* it to obtain such information in this way.

Furthermore, Joyal J.’s holding that s.3 of the *Tax Convention Act* leads to the tax treaty overriding domestic law is of debatable constitutional propriety. It amounts to a tax treaty increasing an exposure to tax and diminishing taxpayers’ rights. Admittedly, a holding that information could only be obtained if Canadian tax was at stake would much restrict Article XXVII’s scope – but, as *Burbank* illustrates, to no greater an extent than that which the US tax authorities felt was already the case. It is unlikely that the US tax authorities’ perception was changed consequent upon the replacement of 1942 tax treaty (at issue in *Burbank*) by its 1980 successor – for two reasons. Firstly, this perception was based upon Canadian domestic law – which remained unchanged. Secondly, the 1942 and 1980 tax treaties contain very similar wording in this respect.

13.05 *The position in the requested State if, were it to request information in a reverse situation to the one at issue (i.e. where its tax is at stake), its laws would not permit it to obtain the requested information*

This reverse situation requires some clarification. If (a requested) State A's laws preclude it from obtaining information which (a requesting) State B has asked for, that is the end of the matter – see Chapter 13.04. However, what if State A's laws permit it to obtain this information simply because the tax at issue is the treaty partner State's tax, and not its (State A) tax – even though, were its (State A) tax at stake, its (purely domestic) laws would preclude it (State A) from requesting or obtaining this information? In other words, what if the requested State's laws would not permit it to obtain the information were the situation in the requesting State to exist in the requested State?

As indicated in Chapter 13.02, the IRS argued in *Lincoln First Bank* that although the US would be precluded from obtaining information when a US criminal tax prosecution had been recommended, it should not be precluded from obtaining information at Norway's request when a Norwegian criminal tax prosecution had been recommended. The Judge simply bypassed this argument by holding that he would not permit information to be exchanged where, as in this case, it was not shown that the requesting State could obtain this information under its laws.

However, a comparable argument was made by the IRS in US: March 18 1983 *Manufacturers* and February 28 1989 *Stuart* (both Article 26).

Manufacturers and *Stuart*, in common with *Burbank* (above), both involved Article XXI(1) of the 1942 Canada tax treaty. This empowered the Commissioner to furnish such information as he “is entitled to obtain under the revenue laws of the USA”.

In *Manufacturers* the taxpayer argued that this phrase simply incorporated all the domestic laws (including the full judicial gloss) governing IRS summonses and their enforcement. However, the 2nd Circuit held (703 F.2d 51): “... the judicial gloss need not be the same for an international case of this type as for a wholly domestic one. The constitutional and governmental considerations are quite dissimilar. On that view the key words in Article XXI(1) emphasize the information the Commissioner “is entitled to obtain” – he can have different “entitlements” under “the revenue laws of the US” in the two separate kinds of cases.”

In *Stuart*, Justice Brennan (giving the majority opinion in the Supreme Court) held (103 L Ed 2d 404): “... Respondents contend that because the IRS would not be able, under American law, to issue an administrative summons to gather information for use by the Government once a Justice Department referral was in effect, the IRS is not in a position to obtain such information once Canadian authorities have reached a corresponding stage in their investigation.

We are not persuaded by this argument. ... Articles XIX and XXI both refer to information that the IRS may obtain under American law. American law, however, does not contain the restriction respondents claim to find there. Section 7602(c) only limits the issuance of summonses when a Justice Department referral is in effect; it

says nothing about decisions by foreign tax officials to investigate possible violations of their countries' tax laws with a view to criminal prosecution outside the US."

Manufacturers and *Stuart* thus hold that even though the IRS may not be able to obtain information for US domestic tax purposes if a US tax investigation has reached the stage of a Justice Department referral by the IRS, the IRS may obtain information for Canadian tax purposes even if a Canadian criminal tax investigation has reached a stage analogous to a Justice Department referral – providing the information requested is obtainable by the Canadian tax authorities under Canada's laws.

Stuart does not hold that where the obtention of information is permissible under the law of the requesting State, the law of the requested State (the US) *can be expanded* to match that applicable in the requesting State – but it does hold that US law *is more expansive* once a tax treaty request has been made. This debatable distinction prompts two questions: how much more expansive can US law be – and what is to determine the limits of such expansion?

It would seem that the only limit on such expansion is that US law cannot be broader than that in the requesting State – so that *non-US* law is, effectively, to determine the limits of US law. Such a result must cause some unease.

Those uneasy with *Stuart's* reasoning and result will not be reassured by the December 5 1988 oral argument before the Supreme Court by the US Deputy Solicitor General, Lawrence G. Wallace. He argued that "sensitive foreign policy issues" should preclude US courts from investigating the good faith of a treaty partner State requesting information. Such investigation was best left to the IRS – even if, for example, a foreign State was harassing a US citizen for his political views.

If the obtention and supply of such information is left to the tax authorities of the requested State, they will have a discretion whether or not to comply with treaty requests. Even if the existence of this discretion does not amount to giving tax authorities the power to increase tax, it does amount to giving them the power to increase an exposure to tax – and foreign tax to boot. This raises obvious constitutional issues.

13.06 *US Exchange of Information Articles may asymmetrically disadvantage taxpayers*

The Exchange of Information Articles in the 1942 and 1980 Canada/US tax treaties have come close to being interpreted to give "Heads the IRS wins, Tails the taxpayer loses" results. *Canada: July 4 1991 Montreal Aluminium* (Chapter 13.02) holds that a requesting State can obtain more information internationally than it can obtain domestically. *Burbank* (Chapter 13.03) holds that a requested State's law can apply even if it is broader than the requesting State's law. *Manufacturers* and *Stuart* (Chapter 13.05) hold that the broader a requesting State's law is, the broader US law can be – with the IRS having a seemingly unlimited discretion whether or not to apply it.

Chapter 14 Article 31(2): Text, preambles and annexes

Article 31(2) of the Vienna Convention runs in part (bold added): “2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes ...”

14.01 Preambles and annexes

Article 31(2) begins by providing that a treaty’s preamble and annexes are part of the a treaty. As Para. 13 of its ILC Commentary notes: “That the preamble forms part of a treaty for purposes of interpretation is too well settled to require comment, as is also the case with documents which are specifically made annexes to the treaty.”

The fact that preambles and annexes are part of a treaty means that, because this treaty will have been incorporated into domestic law (where this is necessary) the weight to be given to such material will be identical at both public international and domestic levels.

A tax treaty’s preamble will typically describe the principal purpose(s) of the treaty. Chapter 11 describes the purposes of tax treaties – and comments that tax treaty preambles often omit several purposes. The avoidance of double taxation is, however, typically mentioned as a tax treaty’s primary purpose (see Chapter 11.01).

In Canada: November 30 1954 *Saunders* (Article 19), in a much approved comment (see Chapter 11.03), Chairman Fordham held (54 DTC 526): “Tax conventions are negotiated primarily to remedy a subject’s tax position by the avoidance of double taxation rather than to make it more burdensome. This fact is indicated in the preamble to the [1942 US] Convention.”

Nearly 40 years later, Hugessen J.A. echoed Chairman Fordham and commented in Canada: February 19 1992 *Utah Mines* (Article 7 and see Chapter 11.10; 92 DTC 6196): “It is quite clear that the purpose of the [1942 US] Convention is to avoid double taxation of enterprises doing business in the two countries and, to that end, to provide for the equitable allocation of the profits of such enterprises as between the two contracting powers. That purpose appears most clearly from the preambles both to the original Convention and to the amending Convention of 1950.”

Hugessen J.A. continued later (92 DTC 6197): “The interpretation proposed by the appellant ... would have the effect of giving a US taxpayer with a permanent establishment in Canada a more favourable tax treatment than its Canadian competitor engaged in the same business in this country. Such a result would not be in accordance with the policy expressed in the preamble to the Convention and indeed would be contrary to it.”

A term in a tax treaty’s preamble should probably be given an even more “ordinary” meaning than a term in a tax treaty Article. Thus in New Zealand: October 2 1992 *Squibb* (Article 26 and see Chapter 11.04) Eichelbaum C.J. commented (13 NZTC 8,133): “The preamble to the Agreement sets out its purposes as the “avoidance of double taxation, and the prevention of fiscal evasion with respect to taxation on

income". Taken by itself, in the context of a preamble I would not place undue emphasis on the term "evasion". Although in tax parlance it is generally taken to connote the deliberate avoidance of tax liability, in a popular sense it is capable of being regarded as referring more broadly to any situation where less tax is being paid than ought to be the case."

A tax treaty's preamble may also throw light on subsidiary interpretative issues – such as whether income should include capital gains and whether capital gains should include business gains.

Canada: January 25 1983 *Gadsden* (Article 13 and see Chapters 9.04 and 24.03) involved the 1966 and 1980 UK tax treaties, both of which only mentioned the words "capital gains" in their preambles and in the headings to the "Capital Gains" Articles. Did these Articles, which did not include the word "capital" in their text, apply to *any* gains – or just *capital* gains?

Mr. Tremblay commented (83 DTC 134): "It seems that headings can only be used when the language of the enactment is ambiguous." He continued later (83 DTC 135): "... it is not clear that the said "gain" may apply indifferently to capital gain and to business profit (or business gain). Therefore, the heading "Capital gain" may be used to construe the said articles. In light of the preambles, it is a fair and reasonable interpretation to conclude that the meaning of the word "gain" in the said articles means "Capital gain"."

Accordingly, he held that these Capital Gains Articles did not cover business gains.

Sweden: *December 23 1987 Supreme Court* (Article 13) involved the 1960 UK treaty, Article II(2) of which had been introduced by a 1968 Protocol. Article II(2) provided that treaty relief would not apply to "income" from a source in Sweden which was not remitted to the UK – and which did not, therefore, suffer UK tax. Did such "income" include a capital gain – which Sweden first sought to tax in 1983?

The minority felt that because Swedish tax law did not distinguish between income and capital, "income" should include both income and capital gains. Furthermore, although both the title and the preamble referred only to "income" as being dealt with under the treaty, capital gains were dealt with in Article XII(3). Accordingly, the (1960) word "income" in the title and the preamble had to include capital gains – and the (1968) word "income" in Article II(2) had to be interpreted similarly.

The minority also pointed out that in 1968 (when Article II(2) was introduced) a capital gain of the type in issue was not subject to any Swedish tax. Accordingly, the negotiators could not have focused specifically on whether the word "income" should include such a capital gain – because capital gains only became taxable in Sweden in 1983. The intent of Article II(2) was to prevent *any* "income" from avoiding tax in both States – so the (1968) word "income" had to include the capital gain.

The majority, however, held that the (1968) word "income" from a source in Sweden did not cover the capital gain in issue – see Chapters 5.04, 10.13, 20.03 and 25.02.

Chapter 15 Article 31(2)(a) and (b) Contemporaneous agreements and instruments

Article 31(2)(a) and (b) of the Vienna Convention runs: “2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;

(b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.”

The weight to be given to contemporaneous material becomes clearer, as always, if it is considered at two levels – the public international level and the domestic level.

15.01 *Contemporaneous agreements and instruments at a public international level*

Article 31(2)(a) and (b) of the Vienna Convention provides that contemporaneous agreements and instruments between *States* rank as part of the *context* of the treaty.

Para. 13 of its ILC Commentary notes: “whether these documents are an actual part of the treaty depends on the intentions of the parties in each case.”

At a public international level, it may matter little whether contemporaneous agreements or instruments rank as part of a treaty – or only as part of its *context*. In either case, they will bind States *as between themselves*.

15.02 *Contemporaneous agreements and instruments at a domestic level*

At a domestic level, however, it is always vital to distinguish between what is part of a treaty and what is only part of its context. This is because, as Chapter 14 explains, only the treaty text (and its preamble and any documents annexed thereto) will normally have the force of law domestically. A contemporaneous agreement or instrument which does not form part of a tax treaty will not have the force of law domestically – because, unlike the tax treaty itself, it will not be a (self-executing) treaty (which, in some States, may have a status superior to or equal to domestic law) nor will it have been enacted as domestic law.

Thus, in relation to the UK, Oliver commented (1970, 388): “For a treaty which purports to affect the private rights of a subject to take effect it must therefore be incorporated into the domestic law of the State concerned.”

Lord Atkin commented in *Attorney-General for Canada v. Attorney-General for Ontario* ([1937] A.C. 347): “Within the British Empire there is a well-established rule that the making of a treaty is an executive act, while the performance of its obligations, if they entail alteration of the existing domestic law, requires legislative action. Unlike some other countries, the stipulations of a treaty duly ratified do not, within the Empire, by virtue of the treaty alone, have the force of law.”

At a domestic level, accordingly, contemporaneous agreements can only be regarded

as conclusive as to the meaning of a tax treaty term if they are expressly referred to in, or are annexed to, *the text* of a tax treaty. In the absence of such a reference or annexation, such an agreement will simply be an agreement between competent authorities – and will not have the force of law domestically.

In the House of Lords in *Fothergill* (see Chapter 3.13) Lord Fraser of Tulleybelton commented ([1981] A.C. 288): “I can conceive of no good reason why the agreed construction should not be expressly set out in an interpretation section of the statute giving effect to the convention. If that is not to be obligatory, as in my opinion it ought to be, then at the very least the statute should draw attention to the agreement. I agree with Kerr J. that the statute should expressly provide that any report by an official rapporteur may be referred to as an aid to its interpretation. That would at least draw attention to the existence of such a document.”

Although competent authority agreements which have not been incorporated into domestic law (or a tax treaty) should never be conclusive as to the meaning of treaty terms, they may have some weight at a domestic level – the extent of which will vary. The factors determining the weight to be given to what, at a domestic level, is supplementary means of interpretation are discussed in Chapter 21.

15.03 *Should contemporaneous competent authority agreements be conclusive?*

The fact that competent authority agreements can typically only have the force of law domestically if they are referred to in the text of a tax treaty, or are annexed to it, must be distinguished from the issue of whether such agreements *should* have the force of law – if, say, they have been reached pursuant to an express authority in a tax treaty.

The 1992 ALI Report recommends (47, italics added): “2. A contemporaneous agreement of the treaty countries as to the meaning of a term used in the treaty, published in the course of the ratification process, should be *conclusive* as to the meaning to be given to that term.”

This ALI Recommendation does not distinguish *text* from *context* – a distinction which is vital at a domestic level. As a result, it recommends the adoption, at a domestic level, of an approach which may be even broader than that applicable at a public international level.

This Recommendation also prompts various questions. What is an “agreement of the treaty countries”? For how long after a tax treaty has been concluded can an agreement be *contemporaneous*? Is any agreement published before ratification has been completed in each (or either?) State a contemporaneous agreement – even if, as happens, ratification only occurs years after a tax treaty has been concluded?

These questions highlight the fundamental constitutional issue of whether *any* competent authority agreement (contemporaneous or subsequent) can govern the meaning of treaty terms, deny treaty relief – and hence, effectively, impose tax. This issue is not discussed in any detail in the 1992 ALI Report.

15.04 *OECD and UN Models and Commentaries*

It has been suggested (see Chapter 23) that OECD (and presumably UN) Models and Commentary can fall within Article 31(2) of the Vienna Convention because this material has been agreed to by OECD Member States. This suggestion is unfounded – for two reasons.

Firstly, this OECD and UN material is neither an *agreement* made in connection with the conclusion of a treaty nor an *instrument* related to a treaty and made in connection with the conclusion of a treaty – see Chapter 23.15.

Secondly, OECD and UN materials themselves confirm that only a tax treaty itself constitutes a “legally binding” international agreement or instrument – see Chapter 23.16.

Nevertheless, this such an agreement or instrument may constitute valuable supplementary means of interpretation – see Chapters 23 and 26.

Chapter 16 Article 31(3)(a): Subsequent agreements

Article 31(3)(a) of the Vienna Convention runs: “There shall be taken into account, together with the context: (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions; ...”

The weight to be given to subsequent agreements becomes clearer, as always, if it is considered at two levels – the public international level and the domestic level.

16.01 Subsequent agreements at a public international level

Under Article 31(2) of the Vienna Convention, only a contemporaneous agreement or instrument can be part of the context of a treaty – see Chapter 15. This recognises that a contemporaneous agreement should normally be accorded more weight than a subsequent agreement – see Chapter 21.05.

Nevertheless, Article 31(3)(a) of the Vienna Convention requires any subsequent agreement to “be taken into account” in interpreting the meaning of a treaty term – even though, by definition, it can never be part of a treaty’s context.

The reason why any subsequent agreement between treaty partner States must be taken into account at a public international level is that, *as between themselves*, States can agree to anything – past, present or future. Treaty partner States can agree today on what they meant when they originally signed a treaty centuries earlier.

As Sinclair points out (1980, 136): “In its advisory opinion in the *Jaworzina* case, the Permanent Court of International Justice ruled as early as 1923 that: “... it is an established principle that the right of giving an authoritative interpretation of a legal rule belongs solely to the person or body who has the power to modify or suppress it. [Footnote 82: P.C.I.J., ser. B, No. 8, at 37]”

At a public international level therefore, it matters little whether a subsequently agreed “authoritative interpretation” by both States is either publicised or correct – because even a non-publicised incorrect interpretation will amount to both States agreeing, as they may, to change their original bargain.

At this public international level, it also matters little whether a subsequent agreement is between *States* themselves (i.e. a fully-fledged treaty) or is merely an agreement between States’ *competent authorities* – because, as between themselves, States will typically be bound by both. Even in the absence of any authority in a tax treaty to conclude agreements, competent authorities must have an implied authority to bind their States. For this reason, Article 31(3)(a) covers *any* agreements.

At a domestic level, however, very different considerations apply – see Chapter 16.03.

Para. 33 of the Commentary on Article 25 of the 1977 OECD Model (which is identical to Para. 36 of the Commentary on Article 25 of the 1992 OECD Model) confirms that any competent authority agreements are binding on the treaty partner States themselves. Para. 33 runs (*italics added*): “Mutual agreements resolving general difficulties of interpretation or application are binding on administrations *as long as the*

competent authorities do not agree to modify or rescind the mutual agreement.”

These italicised words confirm that, just as States can agree to change their original bargain at any time, so can their competent authorities.

US: Rev. Rul. 72-437 (Article 25) confirms that States must apply, *as between themselves*, agreements between their competent authorities reached pursuant to an express authority. Rev. Rul. 72-437 holds (italics added): “... if the competent authorities of the US and Germany reach agreement under Article XVII [the Mutual Agreement Article] of the US-Federal Republic of Germany Income Tax Convention, including agreements dealing with attribution of profits between an enterprise of one country and its permanent establishment in the other country, allocation of profits between related enterprises, or the source of items of income, *each of the contracting States must implement the agreement* in the determination of tax liability.”

It is noteworthy that the above OECD and US comments both ignore the effect of such agreements on taxpayers. No doubt this is because taxpayers have no standing at a public international level. For example, they cannot sue a State at a public international level if it breaches a treaty or a subsequent agreement – see Chapter 27.02.

As Lord Reid commented in UK: March 2 1961 *Collico* (Article 10, 39 T.C. 530): “Although the infringement of a treaty may cause loss to individuals, the only person properly entitled to complain of such infringement is the other party to the treaty.”

16.02 *Subsequent agreements between States at a domestic level*

Article 31(3)(a) of the Vienna Convention covers *any* agreements because, at a public international level, States are bound by any agreements they make – even if they do not take the form of a fully-fledged treaty which is incorporated into domestic law.

At a domestic level, however, Article 31(3)(a) of the Vienna Convention is primarily relevant to fully-fledged tax treaties (which, typically, have a status equal or superior to domestic law because they are self-executing or because they have been enacted as domestic law). I describe these treaties as subsequent agreements between *States*.

At both public international and domestic levels, the rank of such subsequent agreements between *States* will be at least comparable to the original (tax) treaty – because they will have been executed in the same way as this original treaty, and incorporated into domestic law.

In a tax treaty context, such subsequent agreements between *States* usually take the form of Protocols or Supplementary Conventions. These will typically replace or modify Articles in the original tax treaty – rather than interpret them. Nevertheless, they could specifically interpret an existing tax treaty.

16.03 *Subsequent agreements between competent authorities at a domestic level*

At a domestic level, a subsequent agreement between *competent authorities* will not, by definition, be a fully-fledged treaty – nor will it have been incorporated into domestic law. It will not, therefore, have the same status as a fully-fledged agreement between *States* – which is a treaty and/or which has the same force as domestic law

because it has been incorporated into domestic law.

Accordingly, even when a tax treaty authorises competent authorities to subsequently agree on how treaty benefits may be obtained, or on how a treaty is to be interpreted or applied, domestic courts may not accept that their determinations – because these determinations do not have the force of law possessed by the tax treaty itself.

At a domestic level such agreements are, therefore, best classified as supplementary means of interpretation – so they are discussed in Chapter 27.

The fact that subsequent agreements between competent authorities should typically be given far more weight at a public international level, than at a domestic level, may lead to them being interpreted differently at each level. However regrettable any resulting differences may be, it is a small price to pay to ensure that States' constitutional principles are respected.

Additional differences (or inequalities, see Chapter 12) may also occur as between different States – because their different Constitutions may oblige them to give differing amounts of weight to competent authority agreements. This may lead to such an agreement being upheld in one State but disregarded in its treaty partner State – an obviously inconsistent and unreciprocal result.

The more all these differences are appreciated, the more likely it is that tax treaties will be modified to reflect constitutional realities in treaty partner States. The more likely it will then be that different States will give comparable weight to subsequent agreements – and interpret them uniformly and reciprocally.

Chapter 17 Article 31(3)(b): Subsequent practice

Article 31(3)(b) of the Vienna Convention runs: “There shall be taken into account, together with the context: ...

(b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation; ...”

The weight to be given to subsequent practice becomes clearer, as always, if it is considered at two levels – the public international level and the domestic level.

17.01 *Subsequent practice at a public international level*

Article 31(3)(b) only applies to subsequent *practice* establishing the agreement of the parties – i.e. *all* the parties.

As Sinclair comments (1984, 137): “The value and significance of subsequent practice will naturally depend on the extent to which it is concordant, common and consistent. [Footnote 88 runs in edited form: Yasseen 1976, 48.] A practice is a sequence of facts or acts and cannot in general be established by one isolated fact or act or even by several individual applications.”

Because subsequent practice must establish the agreement of all the parties, such practice should be a practice common to all (i.e. in the case of a bilateral tax treaty, *both*) Contracting States.

If subsequent practice does not fall within Article 31(3)(b) of the Vienna Convention, it may still be taken into account under Article 32 – see Chapters 21 and 27. As Sinclair comments (1984, 138): “It should of course be stressed that paragraph 3(b) of Article 31 of the Convention does not cover subsequent practice in general, but only a specific form of subsequent practice – that is to say, concordant subsequent practice common to all parties. Subsequent practice which does not fall within this narrow definition may nonetheless constitute a supplementary means of interpretation within the meaning of Article 32 of the Convention. [Footnote 93 runs in edited form: Yasseen 1976, 52]”

At a public international level, account must be taken of *any* subsequent practice (as defined) – just as account must be taken of any subsequent agreements (see Chapter 16). Even non-publicised, informal practices between tax authorities may establish an agreement between States to interpret a treaty term in a particular way.

17.02 *Subsequent practice at a domestic level*

At a domestic level, however, there is the same crucial distinction between a fully-fledged tax treaty between States and the subsequent practice of States (or their tax authorities) as there is between a fully-fledged tax treaty between States and subsequent agreements between tax authorities. Informal practices cannot, by their very nature, have been executed in the same way as a fully-fledged tax treaty itself or incorporated into domestic law.

At a domestic level, the issue of whether the subsequent practice of States (or their

tax authorities) should determine the meaning of existing tax treaty words raises many questions. For example, should the practice of tax authorities be given so much weight that it determines the meaning of *any* term – and, effectively, imposes tax?

Domestic courts in some States have recognised that, although account should be taken of the practice of treaty partner States at a public international level *as between States themselves*, this may be inappropriate at a domestic level – where a taxpayer's rights and obligations are governed solely by the tax treaty (or by the domestic law incorporating the treaty into domestic law). However, domestic courts in other States have accorded great weight to the subsequent practice of States and their tax authorities.

In Germany: *October 9 1985 BFH* (Article 7 see Chapters 6.05 and 27.13) the German Federal Ministry of Finance unsuccessfully invoked the Vienna Convention to support its claim that the practice of the US and German tax authorities since the signature of the 1954 US tax treaty was evidence as to the meaning of this treaty's text. The BFH noted that although Germany had signed the Vienna Convention, it had not ratified it. Even were this Convention to be applied, however, the BFH held that there was insufficient evidence of practice by both States indicating their agreement to interpret the treaty in the way suggested by the tax authorities. Material (analysed in Article 7) involving the US and its other treaty partner States – including the UK (see US: January 12 1977 News Release) and Canada (see US: March 5 1982 *Great-West*) – did not evidence US/German practice. The fact that the US and German tax authorities interpreted the tax treaty similarly, to a taxpayer's disadvantage, could not preclude the application of normal principles of treaty interpretation at a domestic level.

As noted in Chapters 6.05 and 11.03, Germany: *January 20 1993 BFH* (Article 7), which conflicts with *October 9 1985 BFH*, found sufficient indication of the purpose of the treaty (in, for example, Article 10(5) of the 1977 OECD Model – see Chapter 26.01) for it to interpret its terms in the way suggested by the tax authorities.

US domestic courts have long held that the subsequent practice of treaty parties may establish their agreement as to the meaning of a treaty provision. Such practice may even be held to have arisen as a result of a foreign decision. Thus, in *Pigeon River Improvement, Slide & Boom Co. v. Charles W. Cox Ltd.*, (211 U.S. 138 (1934)), the US Supreme Court held that a Canadian Supreme Court decision determined the interpretation of a (non-tax) treaty – see Chapter 29.16.

In US: *October 22 1975 Burbank* (Article 26) the taxpayer (for once) urged, in Mulligan J.'s words (525 F.2d 14): “that the practical construction of the Treaty by the contracting states must be given great weight in its interpretation. *Kolovrat v. Oregon*, 366 U.S. 187, 194, 81 S.Ct. 922, 6 L.Ed.2d 218 (1961).”

Mulligan J. sidestepped this argument by holding that the 1942 Canada treaty might only have been construed in the way suggested by one contracting State (Canada) – and that even had it been so construed, this would not help the taxpayer. He held (525 F.2d 15; Chapter 13.07): “It may represent the Canadian view but it does not represent the *American* interpretation.”

The most striking examples of a failure to recognise that the subsequent practice of States should not necessarily determine the meaning of a tax treaty term at a domestic level have arisen in the US Supreme Court.

O'Connor v. US (93 L Ed 2d 206) involved the Panama Canal Treaty – Article XV of which exempted US citizens from: “*any taxes ... on income received as a result of their work for the [Panama Canal] Commission*” (italics added). The Supreme Court held that Article XV only applied to Panamanian taxes – in accordance with the consistent application of the Treaty by the US and by Panama.

Justice Scalia (delivering the opinion of the Supreme Court) held (93 L Ed 2d 213 and 214): “Not only is limitation of Article XV to Panamanian taxes in accord with the consistent application of the Agreement by the Executive Branch – a factor which alone is entitled to great weight, see *Sumitomo Shoji America, Inc. v. Avagliano*, 457 US 176, 184-185, 72 L Ed 2d 765, 102 S Ct 2374 (1982) – but that application has gone unchallenged by Panama. It is undisputed that, pursuant to clear Executive Branch policy, the Panama Canal Commission consistently withheld United States income taxes from petitioners and others similarly situated, see Letter from John L. Haines, Jr., Deputy General Counsel, Panama Canal Commission, to David Slacter, United States Department of Justice, Dec. 20, 1982, pp 2-3, 1 App in Nos. 85-504, 85-505, 85-506, and 85-507 (CA Fed), pp 61-62, and that Panama, which had four of its own nationals on the Board of the Commission, did not object. The course of conduct of parties to an international agreement, like the course of conduct of parties to any contract, is evidence of its meaning. See *Trans World Airlines, Inc. v. Franklin Mint Corp.* 466 US 243, 259-260, 80 L Ed 2d 273, 104 S Ct 1776 (1984); *Pigeon River Improvement, Slide & Boom Co. v. Charles W. Cox, Ltd.* 291 US 138, 158-161, 78 L Ed 695, 54 S Ct 361 (1934). Cf. Uniform Commercial Code Section 22-208(1) (1978). [Footnote 2: “The Government has contended, here and before the Court of Appeals, that the answer to the current question is illumined, if not conclusively determined, by a February 22, 1985, diplomatic note from the Government of Panama, indicating that it shares the US’ view that Article XV pertains only to Panamanian taxation. The petitioners assert that mutual agreement between the contracting parties on interpretation cannot be dispositive of third-party rights, and that the note is in any event inadmissible on various grounds. Since we would sustain the Government’s position without reference to the note, we need not resolve these disputes.]”

Whilst one can sympathise with the decision in *O'Connor*, one can only have far less sympathy with the view that States’ subsequent practice can determine, for example, the scope of a tax treaty’s Exchange of Information Article.

However, such a holding was reached, arguably *obiter*, in US: February 28 1989 *Stuart* (Article 26 and see Chapter 13.05). Justice Brennan, delivering the majority opinion of the Supreme Court, held (103 L Ed 2d 406): “The practice of treaty signatories counts as evidence of the treaty’s proper interpretation, since their conduct generally evinces their understanding of the agreement they signed. See *Trans World Airlines, Inc. v. Franklin Mint Corp.*, 466 US 243, 259, 80 L Ed 2d 273, 104 S Ct 1776

(1984); *Factor v. Laubheimer* 290 US 276, 294-295, 78 L Ed 315, 54 S Ct 191 (1933). The Government's regular compliance with requests for information by Canadian authorities without inquiring whether they intend to use the information for criminal prosecution therefore weighs in favor of its reading of Articles XIX and XXI."

At a domestic level, very comparable principles should determine what weight should be accorded to subsequent agreements between competent authorities – and their subsequent practice. Accordingly, no distinction is generally made between such agreements and practice; they are both discussed in Chapters 21 and 27.

One principle, however, is of particular relevance. As Chapter 21.04 indicates, no account should be taken, at a domestic level, of agreements which have not received adequate publicity. This principle applies equally to practice – which, by its nature, is not normally publicised to the same extent as subsequent agreements. However concordant, common and consistent it may be, subsequent practice should not be taken into account at a domestic level if, as will often be the case, it has not been publicised sufficiently for taxpayers generally to be aware of it.

Chapter 18 Article 31(3)(c): Other relevant rules of international law

Article 31(3)(c) of the Vienna Convention runs: “There shall be taken into account, together with the context: ...

(c) any relevant rules of international law applicable in the relations between the parties.”

Article 31(3)(c) is both self evident and unclear. It is self evident that, at a public international level, any relevant rules of international law must be taken into account in interpreting a treaty. It is unclear which “rules” Article 31(3)(c) considers to be most relevant.

Para. 16 of the ILC Commentary reveals that the Vienna Convention had originally attempted to address the issue of “contemporaneity” – i.e. whether treaty terms should be interpreted in the light of the law at the time of a treaty’s conclusion, or whether account should be taken of subsequent developments in the law. In view of its failure to address this issue clearly, it is unsurprising that the Vienna Convention makes no attempt to resolve it. Nevertheless, this ILC Commentary is instructive.

Paras. 9 and 16 of this ILC Commentary make it clear that Article 31(3)(c)’s text had originally appeared (in somewhat different form, as indicated below) in what is now Article 31(1). At that time (1964) Article 31(1) required the terms of a treaty to be determined (*italics added in the ILC Commentary*) “in the light of the general rules of international law *in force at the time of its conclusion*”.

Para. 16 comments: “When this provision was discussed at the sixteenth session [*Footnote 140: Paragraph (11) of the commentary to articles 69-71; Yearbook of the International Law Commission, 1964, Vol. II, pp. 202 and 203*] some members suggested that it failed to deal with the problem of an evolution of the law on the interpretation of legal terms in a treaty and was therefore inadequate. Some Governments in their comments endorsed the provision, others criticised it from varying points of view. On re-examining the provision, the Commission considered that the formula used in the 1964 text was unsatisfactory, since it covered only partially the question of so-called intertemporal law in its application to the interpretation of treaties and might, in consequence, lead to misunderstanding. It also considered that, in any event, the relevance of rules of international law for the interpretation of treaties in any given case was dependent on the intentions of the parties, and that to attempt to formulate a rule covering comprehensively the temporal element would present difficulties. It further considered that correct application of the temporal element would normally be indicated by the interpretation of the term in good faith. The Commission therefore concluded that it should omit the temporal element ...”

Because this temporal issue was only ever mentioned in Article 31(1), and is dependent on the intentions of the parties, it is discussed, notably, in Chapters 9.02, 9.03 and 10.

Chapter 19 Article 31(4): Special meaning

Article 31(4) of the Vienna Convention runs: “A special meaning shall be given to a term if it is established that the parties so intended.”

Because tax treaties contain technical international tax language, some (such as the 1992 ALI Report – 59, 60) take the view that Article 31(4) is frequently relevant in a tax treaty context. Accordingly, they argue that Article 31(4) facilitates references to collateral material, such as OECD and UN Commentaries, which most clearly elucidate special meanings. They contrast the supposed ease of such references with the supposed difficulties of justifying the use of supplementary means of interpretation (such as, again, OECD and UN Commentaries) under Article 32 of the Vienna Convention.

I disagree with this view – and question whether Article 31(4) does make it any easier to consider supplementary means of interpretation.

19.01 A special meaning is “extraordinary”

My view is based on the fact that an Article 31(4) special meaning is “extraordinary” – it is the converse of the ordinary meaning which Article 31(1) of the Vienna Convention requires to be given to treaty terms.

My view is also based on the fact that, as Para. 17 of the ILC Commentary on Article 31(4) makes quite clear, the burden of proof lies on a person contending that a special or extraordinary meaning should apply.

Para. 17 runs: “Some members doubted the need to include a special provision on this point, although they recognized that parties to a treaty not infrequently employ a term with a technical or other special meaning. They pointed out that technical or special use of the term normally appears from the context and the technical or special meaning becomes, as it were, the ordinary meaning in the particular context. Other members, while not disputing that the technical or special meaning of the term may often appear from the context, considered that there was a certain utility in laying down a specific rule on the point, if only to emphasize that the burden of proof lies on the party invoking the special meaning of the term.”

My view is that international tax language in a tax treaty is not “special” or “extraordinary” in its context – where it is normal and *ordinary* language. Thus, most tax treaty terms should not be given an Article 31(4) special meaning – they should be given their *ordinary* meaning in their tax treaty context. Indeed, as Chapter 7.03 illustrates, “ordinary” or “dictionary” definitions will often be more appropriate definitions in a tax treaty context than, say, definitions in one or other of the contracting States’ tax laws – which *are* special in a tax treaty context (see Chapter 19.02).

Nevertheless, because some tax treaty terms are technical, their ordinary meaning in a tax treaty context may be difficult to discern. In such a case, supplementary means of interpretation may be of particular use. For example, OECD and UN materials or

jurisprudence may demonstrate the real and “informed” meaning of a technical tax treaty term – which is, as it were, the ordinary meaning of this term in its tax treaty context.

Even specific definitions in the tax treaty itself will not normally involve “special” meanings – because they will normally be derived from a standard tax treaty Model.

Similarly, the meaning which should be given to an undefined tax treaty term will not normally be a “special” meaning – but the ordinary meaning of this term in its tax treaty context. This ordinary meaning can often be found in OECD materials. For example, the meanings of the terms “entertainer”, “athlete” and “sportsman” in a tax treaty context are indicated in OECD materials – and these ordinary meanings may evolve (see Chapter 9.03). These meanings are not “extraordinary” or “special” at all – in their tax treaty context, they are the ordinary meanings.

I also question whether Article 31(4) makes it easier to consider supplementary means of interpretation (such as OECD and UN materials) – for four reasons.

Firstly, as Para. 17 of the ILC Commentary (above) makes clear, the burden of proof is on those asserting a special and extraordinary meaning. Anyone invoking Article 31(4) as a ground for citing, say, OECD materials must bear this burden.

Secondly, *in practice* this Article 31(4) burden may be heavier than that borne by anyone invoking Article 32 of the Vienna Convention as justification for citing, say, OECD materials. In practice, as Chapters 4.03 and 21.01 explain, it is difficult to avoid the conclusion that Article 32 will always permit references to be made to any material which elucidates the meaning of a tax treaty term – including, *par excellence*, OECD materials (see, for example, Chapter 23.25).

Thirdly, Article 31(4) may only permit the consideration of a narrower range of materials than Article 32. Article 31(4) only permits a special meaning to be given to *a term* – and the scope of some supplementary means of interpretation (notably OECD Commentaries and Reports) can be far wider than the mere interpretation of a term.

For example, much OECD material deals with concepts, characterisations (of income, assets and entities) and the interaction of different Articles. It is arguable that this material can be referred to more easily under Article 32 – thus avoiding arguments as to whether Article 31(4) permits a special meaning to be given to such material. (Similar arguments can arise in relation to whether a provision such as Article 3(2) of the 1977 and 1992 OECD Models permits references to domestic law to define a concept – see Chapter 7.11.)

Fourthly, because the Vienna Convention is primarily applicable at a public international level *as between States themselves*, there is simply no obligation, at a domestic level, to always comply with any Vienna Convention constraints on the use of supplementary means of interpretation. As indicated in Chapters 23.25 and 26.12, many domestic courts have considered OECD materials without seeing any need to justify their action by reference to the Vienna Convention – just as they did before the Vienna Convention ever existed.

19.02 *Special meaning and domestic law*

In line with my view that Article 31(4) should rarely apply in a tax treaty context, I also take the view that it is most likely to apply when an attempt is made to interpret a tax treaty term by reference to domestic meanings which have a provenance unrelated to tax treaties. For example, in relation to Sweden: *December 23 1987 Supreme Court* (Article 13 and see Chapters 20.04 and 20.05) Avery Jones and Oliver have commented (1988, 440, italics added): “There is nothing to prevent the English version being given extra weight in determining ... that the parties intended a *special meaning* to be given to the term “income from a” source, which has a particular meaning in English [tax law].”

My view that Article 31(4) should apply to “special” domestic definitions is consistent with giving the (international tax treaty) context of tax treaty terms the great weight this context deserves – see Chapter 7. The burden of proof should lie on the person seeking to use “special” domestic definitions to interpret an undefined tax treaty term – just as the burden of proof lies on any person invoking any other special meaning.

The fact that a tax treaty contains a provision comparable to Article 3(2) of the 1977 and 1992 OECD Models (which requires an undefined tax treaty term to be defined by reference to domestic law) does not affect the view that some domestic definitions may be “special” in a tax treaty context. Even though Article 3(2) may lessen the burden of proof on a person invoking a domestic meaning (see Sir Ian Sinclair’s remarks to this effect in Avery Jones 1985, 168), it provides that domestic definitions are not to apply where the (international tax treaty) context otherwise requires – see Chapter 7.14.

Chapter 20 Article 33: The equality of plurilingual texts

20.01 Articles 33(1) and 33(2) of the Vienna Convention

Article 33 of the Vienna Convention begins: “*Interpretation of treaties authenticated in two or more languages*”

1. When a treaty has been authenticated in two or more languages, the text is equally authoritative in each language, unless the treaty provides or the parties agree that, in case of divergence, a particular text shall prevail.

2. A version of the treaty in a language other than one of those in which the text was authenticated shall be considered an authentic text only if the treaty so provides or the parties so agree.”

Para. 2 of the ILC Commentary on Article [33] begins: “(2) To-day the majority of more formal treaties contain an express provision determining the status of the different language versions. If there is no such provision, it seems to be generally accepted that each of the versions in which the text of the treaty was “drawn up” is to be considered authentic, and therefore authoritative for purposes of interpretation. In other words, the general rule is the equality of the languages and the equal authenticity of the texts in the absence of any provision to the contrary.”

Article 33’s confirmation that all treaty texts are normally of equal authority is consistent with the principles of “good faith”, “equality” and reciprocity – which require a treaty to be interpreted in accordance with the common intention of all parties (see Chapter 5).

Because Article 33 of the Vienna Convention provides that each authenticated version of a plurilingual treaty is equally authoritative, all such versions should always be interpreted – because they all comprise one composite treaty.

Para. 6 of the ILC Commentary is particularly relevant to tax treaties – which often have two or more authentic texts. Para. 6 runs: “(6) The plurality of the authentic texts of a treaty is always a material factor in its interpretation, since both or all the texts authoritatively state the terms of the agreement between the parties. But it needs to be stressed that in law there is only one treaty – one set of terms accepted by the parties and one common intention with respect to those terms – even when two authentic texts appear to diverge. In practice, the existence of authentic texts in two or more languages sometimes complicates and sometimes facilitates the interpretation of a treaty. Few plurilingual treaties containing more than one or two articles are without some discrepancy between the texts. The different genius of the languages, the absence of a complete *consensus ad idem*, or lack of sufficient time to co-ordinate the texts may result in minor or even major discrepancies in the meaning of the texts. In that event the plurality of the texts may be a serious additional source of ambiguity or obscurity in the terms of the treaty. On the other hand, when the meaning of terms is ambiguous or obscure in one language but it is clear and convincing as to the intentions of the parties in another, the plurilingual character of the treaty facilitates interpretation of the text the meaning of which is doubtful.”

20.02 Articles 33(3) and 33(4) of the Vienna Convention

Articles 33(3) and 33(4) of the Vienna Convention run: “3. The terms of the treaty are presumed to have the same meaning in each authentic text.

4. Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic text discloses a difference of meaning which the application of articles 31 and 32 does not remove, the meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted.”

Article 29(3) of the 1966 Draft (on which the Articles 33(3) and 33(4) of the Vienna Convention are based) ran somewhat differently. It ran: “3. The terms of the treaty are presumed to have the same meaning in each authentic text. Except in the case mentioned in paragraph 1, when a comparison of the text discloses a difference of meaning which the application of articles 27 and 28 does not remove, a meaning which as far as possible reconciles the texts shall be adopted.”

Paras. 7 and 8 of the ILC Commentary *on the 1966 Draft* run in part: “(7) The existence of more than one authentic text clearly introduces a new element – comparison of the texts – into the interpretation of the treaty. But it does not involve a different system of interpretation. Plurilingual in expression, the treaty remains a single treaty with a single set of terms the interpretation of which is governed by the rules set out in articles [31] and [32]. The unity of the treaty and of each of its terms is of fundamental importance in the interpretation of plurilingual treaties and it is safeguarded by combining with the principle of the equal authority of authentic texts the presumption that the terms are intended to have the same meaning in each text. This presumption requires that every effort should be made to find a common meaning for the texts before preferring one to another. ... the equality of the texts means that every reasonable effort should first be made to reconcile the texts and to ascertain the intention of the parties by recourse to the normal means of interpretation.

(8) *Paragraph 3* therefore provides, first, that the terms of a treaty are presumed to have the same meaning in each authentic text. Then it adds that – apart from cases where the parties have agreed upon the priority of a particular text – in the event of a divergence between authentic texts a meaning which so far as possible reconciles the different texts shall be adopted. These provisions give effect to the principle of the equality of texts.”

20.03 Domestic courts should consider all versions of a treaty text

Despite the existence of Article 33 of the Vienna Convention, which codifies public international law and practice, domestic courts have rarely considered foreign language versions of tax treaty texts. There are several reasons for this.

Firstly, even though a tax treaty may be expressed in different languages, it may itself provide that only one of its texts (normally in the most commonly understood language) is authoritative. This is permissible under Article 33(1) of the Vienna

Convention, even if the only authoritative text is in the language of a third State. For example, the 1979 Argentina/Italy tax treaty provides that the French text is authoritative, and the only authentic text of the 1982 Italy/Yugoslavia tax treaty is in English – see below.

Secondly, the parties may not be able to agree on what foreign language texts mean. Thus in *Australia: August 22 1990 Thiel* (Article 7), which involved the 1980 Switzerland tax treaty, Mason C.J. held (90 ATC 4,719 and 4,720): “As the English and German texts of the Agreement were agreed to be equally authoritative, the meaning of “enterprise” might have been illuminated by evidence of the meaning of the corresponding German text, but no such evidence was given and the parties before this Court were unable to agree upon a translation of the German text.” In light of this, Mason C.J. then focused on OECD Commentary (in English) – see Chapter 23.25.

Thirdly, some courts may only deign to consider foreign language texts if the text in their own language is ambiguous – as UK courts did in the 1930s-1950s. However, this practice is now discredited in the UK. Thus, in the House of Lords in *Buchanan* (see Chapter 3.12) Lord Wilberforce commented ([1978] A.C. 152): “The Convention of 1956 is in two languages, English and French, each text being equally authentic. The English text alone appears in the Schedule to the Act of 1965 and is by that Act (section 1) given the force of law. Moreover the contract of carriage seems to have incorporated contractually this English text. It might therefore be arguable (though this was not in fact argued) – by distinction from a case where the authentic text is (for example) French and the enacted text an English translation – that only the English text ought to be looked at. In my opinion this would be too narrow a view to take, given the expressed objective of the Convention to produce uniformity in all contracting states. I think that the correct approach is to interpret the English text, which after all is likely to be used by many others than British businessmen, in a normal manner, appropriate for the interpretation of an international convention, unconstrained by technical rules of English law, or by English legal precedent, but on broad principles of general acceptance [per Lord Macmillan in UK: *Stag Line* – see Chapter 3.10]. Moreover, it is perfectly legitimate in my opinion to look for assistance, if assistance is needed, to the French text. This is often put in the form that resort may be had to the foreign text if (and only if) the English text is ambiguous, but I think this states the rule too technically. ... There is no need to impose a preliminary test of ambiguity.”

In the House of Lords in *Fothergill* (see Chapter 3.13) Lord Wilberforce again discussed how an English court ought to ascertain the meaning of a word in a foreign language. He commented ([1981] A.C. 273 and 274): “My Lords, as in ... [*Buchanan*] ... I am not willing to lay down any precise rule on this subject. The process of ascertaining the meaning must vary according to the subject matter. If a judge has some knowledge of the relevant language, there is no reason why he should not use it: this is particularly true of the French and Latin languages, so long languages of our courts. There is no reason why he should not consult a dictionary, if the word is such that a dictionary can reveal its significance: often of course it may substitute one doubt for

another. ... In all cases he will have in mind that ours is an adversary system: it is for the parties to make good their contentions. So he will inform them of the process he is using, and, if they think fit, they can supplement his resources with other material – other dictionaries, other books of reference, text-books and decided cases. They may call evidence of an interpreter, if the language is one unknown to the court, or of an expert if the word or expression is such as to require expert interpretation. Between a technical expression in Japanese and a plain word in French there must be a whole spectrum which calls for suitable and individual treatment.”

In the future, even greater attention is likely to be paid to the foreign language versions of a tax treaty – if only because such material must be taken into account under Article 33 of the Vienna Convention. Such an “international” approach is particularly likely to develop in the EU, because much EU material is plurilingual. For example, Article 22 of the draft EU Arbitration Convention (Chapter 2.05) provides that its ten texts in the ten official EU languages are all equally authoritative. Linguists doubtless await the enlargement of the EU with enthusiasm.

20.04 *Domestic courts have considered foreign language tax treaty texts*

When domestic courts or tax authorities have considered the foreign language versions of a tax treaty, they have generally found them very helpful.

Thus Belgium: February 22 1984 Question (Article 18) relied upon the English meaning of the word “alimony” to interpret the meaning of the analogous French term in the 1970 US tax treaty.

In Canada: May 7 1979 *Vauban* (Article 12) a comparison of tax treaty texts revealed a typographical error. Addy J. noted that the English text of Article 13(III) of the France treaty began: “The proceeds of royalties ...” – but that the French text began (capitals added): “Les produits OU redevances ...” He thought it clear that there was (75 DTC 5372): “a typographical error in the English version” of Article 13(III) which should have begun (capitals added): “The proceeds OR royalties ...”

In Canada: January 29 1968 *Furness Withy* (Article 8) the issue was whether a Canadian branch offering shipbroking and stevedoring services was “operating ships” within the meaning of Article V of the 1946 UK tax treaty. This treaty had an equally authoritative French text – as did applicable Canadian domestic law. Thurlow J. found these French treaty and domestic texts helpful. He noted (66 DTC 5365): “Finally, the French language text, which also states the law in this country, in section 10(1)(c) expresses the meaning of *operated by him* by the words “qu’elle met en service” and the corresponding expression “de la mise en service” is used in Article V to represent the meaning of *operated by* in the English language text of Article V. The French expressions so used appear to me to be apt ones to refer to operation by an owner or charterer who puts a ship into service in the trading in which he is engaged and to be quite inept to embrace or refer to one who simply carries out tasks, however extensive, for such an owner or charterer whether generally or in a particular geographical area into which the ship is sent in the course of a voyage.”

In Canada: April 26 1991 *Gu* (Article 15) Bonner T.C.J. held (91 DTC 824): “The English and French versions of Article 19 [of the 1986 China tax treaty] may usefully be compared, especially the words “... receives for the purpose of his maintenance, education or training ...” and the words “... reçoit pour couvrir ses frais d’entretien, d’études ou de formation ...”. That language is quite unsuited to describe a payment of ordinary salary no matter how the recipient ultimately spends it. The language suggests that the payments must in some way be related to the recipient’s maintenance costs, education costs or training costs.”

In Canada: November 8 1993 *Crown Forest* (Article 4 and see Chapter 7.03), Muldoon J. compared (91 DTC 6309-6311) the English and the French texts of the 1980 US tax treaty.

Germany: *August 21 1985 BFH* (Article 15) referred to Article 33 of the Vienna Convention in holding that different wording in the “authentic” German and Spanish texts of the 1966 Spain tax treaty should be interpreted to have the same meaning. This different wording probably arose because the treaty had originally been prepared in English; the “authentic” texts were, thus, translations from this English original.

According to Nakazato (1993, 414 Footnote 28) Japan: *April 14 1965 Tokyo District Court* relied upon the English text in interpreting the 1954 US tax treaty, as well as US legislative history – see Chapter 25.13.

Netherlands courts, as might be expected in such an internationally-minded country, often refer to foreign language texts. For example, Netherlands: *February 4 1970 HR* (Article 5) focused primarily on the German text of the 1959 Germany tax treaty in holding that a single construction project had to exceed twelve months before it could constitute a (foreign) permanent establishment.

Netherlands: *January 26 1977 HR* (Article 18 and see Chapter 11.02) involved Article 6 of the 1967 UK tax treaty which provided (italics added): “the *relief* to be allowed ... in the Netherlands shall apply only to so much of the income as is remitted or received in the UK.” “Relief” (in the English text) appeared as “Verminderling” in the Dutch text. These words were held to indicate that Article 6 only applied when the treaty granted a reduction (Verminderling) of tax – and not when it gave an exemption (Vrijstelling) from tax.

Netherlands: *April 15 1992 HR* (Article 23), involving the 1959 Germany tax treaty, rejected the taxpayer’s argument that, because the same German words were used in Article 20(2) (to describe German double tax relief) and in Article 20(3) (to describe Netherlands double tax relief), the differing analogous words in Dutch had to be given the same meaning.

Sweden: *December 23 1987 Supreme Court* (Article 13 and see Chapter 20.05) held that because the 1968 Protocol to the 1960 UK tax treaty had been negotiated in English, particular attention should be paid to its English text. This English text then formed the basis of its decision that a capital gain was exempt from tax in Sweden, even though it was also exempt from tax in the UK – see Chapters 10.13 and 14.01.

Switzerland: *May 10 1989 Zurich Commission* (Article 15 and see Chapters 10.13

and 21.03) involved the words “temporarily present” and their German analogue “vorübergehend” in the 1951 US treaty. It held that the English text was the better guide to the true meaning of the treaty – which sought to distinguish between those intending to remain (in Switzerland) temporarily and those intending to remain there permanently. The treaty did not seek to distinguish between those staying for 183 or more days in total, and those staying for a lesser period. Accordingly, a person who did not intend to remain permanently in Switzerland was only “temporarily present” there.

UK courts have never considered foreign language texts. This is unsurprising – because every UK tax treaty decision bar one has involved a sole text in English.

UK: December 8 1989 *Vas* (Article 14) is the only UK decision involving an equally authoritative text in a foreign language – Hungarian. Vinelott J. did not consider this Hungarian text in coming to his decision (which, incidentally, could have benefited from considering US material – see Chapter 23.21). Presumably this was because neither litigant argued the meaning of this Hungarian text. This may indicate that this Hungarian text was not favourable to Dr. Vas – because he did not exploit his advantage of being one of the few people in the UK capable of interpreting it.

It can also be assumed that this Hungarian text represented a translation of an original in English – the most commonly used language for tax treaties and their Models. Courts may well accord translations a lower status than the original itself – especially when the original is in their own language.

20.05 Translations and the language(s) of negotiations

Article 33 of the Vienna Convention does not give any preference to a treaty text in one language because this language was used exclusively in negotiating and in drafting what became one of the final texts. As Germer commented (1970, 418): “... the interpreter is bound to give effect to the principle of the equality of texts, and it would be a clear violation of that principle if the interpretation considered the original version to be superior to other authentic texts.” However, as Germer himself then commented (1970, 418): “An examination of the preparatory work of a treaty and the circumstances of its conclusion may, however, display the cause of a divergence between the different language versions and thus help to establish the meaning intended by the parties to be attached to the provision in question.”

Inevitably, a translation may not always capture the full flavour of an original in a language familiar to the judge(s). No doubt partly for this reason, the International Court of Justice typically only consults the English and French texts when it interprets the United Nations Charter – even though the Chinese, Spanish and Russian texts are equally authentic.

Germany: July 30 1990 Federal Ruling (Article 15 and see Chapter 26.01) cited the English text of Article 15 of the OECD 1977 Model as support for its holding that *May 10 1989 BFH* (Article 15), which involves the 1959 Netherlands tax treaty, is not to be applied. This reference is understandable – the German text of the 1977 OECD Model is only an unofficial translation prepared by the German Ministry of Finance.

English is being relied upon to an increasing extent in international technical fields; for example, the use of English is effectively mandatory in air traffic control. This increasing use of English is also evident in the tax treaty field; English is the only language which is always used in all OECD and UN tax treaty publications.

English has also become the latest language of diplomacy – and is often the only common language of those negotiating a treaty. For example, the only official texts of the 1982 Italy/Yugoslavia and 1991 Netherlands/Sweden tax treaties are in English. This may explain the regrettable wording of the former's Article 3(2) – which omits its key words “unless the context otherwise requires” (see Chapter 10.13).

Equally regrettable aberrations may occur in the future – especially when treaty negotiations are conducted in a language which is different to that (or those) used in the authoritative text(s). These translations may reveal that even though treaty negotiators used a single language, they were not using the same language. Seemingly concurring negotiators may, in reality, be divided by a common language.

Sundgren has complained that Sweden: *December 23 1987 Supreme Court* (Article 13 and see Chapter 20.04) paid particular attention to the English text of the 1960 UK treaty – because the treaty negotiations had been conducted in English. He has commented (1990, 300 and 301): “It is true that Swedish is a “small” language mastered by very few people outside Sweden. Our treaty negotiators and diplomats, however, are very skilled in foreign languages, especially English. Thus it is perfectly natural that treaty negotiations (especially in England) are conducted in English without interpreters and translators. After negotiating the original and in this case English draft a lot of effort goes into the Swedish translation. Subsequently both texts are meticulously scrutinised by both the contracting states before signing the final treaty text. The fact that the text was originally drawn up in English and initialled by civil servants representing the treaty partners must not be regarded as a concession by Sweden for interpretation purposes. This is the whole point of equally authoritative texts. It is a sad and embarrassing fact that the Swedish Supreme Administrative Court majority (Dahlman, Hamdahl, Werner) have failed to recognise and respect such basic principles of treaty interpretation embodied in the Vienna Convention.”

Despite Sundgren's views, the fact that treaty negotiations are carried out in the language of one treaty partner State is not a “concession by [the other State] for interpretation purposes.” The equality of treaty texts cannot change the reality that all treaty texts may not be equally clear. This equality simply reflects the equality of States – and the principle that a bilateral (tax) treaty has to be interpreted in accordance with the common understanding of *both* States (see Chapter 5). It does not alter the fact that a treaty text in one language (such as that in which it was originally negotiated, drafted and initialled) may well be a truer reflection of both States' understanding than an equally authoritative, albeit less helpful, text which only came into existence as a translation of this initialled text. No doubt this explains why, although the 1994 Sweden/Vietnam tax treaty has three “equally authoritative” versions (Swedish, Vietnamese and English), “in case of divergency the English text shall prevail.”

Part III The Vienna Convention: Article 32 – supplementary means of interpretation**Chapter 21 Supplementary means of interpretation**

Article 32 of the Vienna Convention runs: “*Supplementary means of interpretation*

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

(a) leaves the meaning ambiguous or obscure; or

(b) leads to a result which is manifestly absurd or unreasonable.”

21.01 The definitions of “supplementary means of interpretation” and other terms

Article 32 of the Vienna Convention provides that recourse may be had to supplementary means of interpretation to *confirm* the meaning resulting from the application of Article 31.

From this, Avery Jones *et al.* conclude (1984, 97): “... travaux préparatoires can be used only to confirm, and not to contradict, [Footnote 31] the interpretation under Article 31 ...” Footnote 31 begins: “It follows that if the person interpreting the treaty turns to the supplementary means for confirmation of the meaning found by Art. 31 and instead he finds contradiction, it must be ignored.”

This conclusion seems to conflict with the Vienna Convention’s interpretative approach – which, far from requiring supplementary means of interpretation to be “ignored” just when they are at their most useful, requires quite the contrary. Under this Vienna Convention approach, the more supplementary means of interpretation suggest a meaning for a term which conflicts with an apparently clear meaning, the less such means should be ignored – because they suggest that genuine or “informed” clarity should prevail over apparent clarity.

In practice, even when the application of Article 31 results in a meaning which is apparently clear (i.e. neither ambiguous nor obscure) one can only be certain that such apparent clarity accords with genuine or “informed” clarity by recourse to supplementary means of interpretation – see Chapter 4.03. Typically, therefore, counsel (on both sides) will invoke supplementary means of interpretation to confirm their (opposing) views on the meaning of a treaty term.

In practice, it is thus both permissible and usual for recourse to be had to supplementary means of interpretation to confirm an apparently clear meaning – and to show that this meaning is, in fact, neither ambiguous nor obscure. As a result, the issue of whether material *has* to be considered under Article 31 of the Vienna Convention (as, say, part of the treaty’s “context” – see Chapter 14), or *may only* be considered under Article 32 (as supplementary means of interpretation), will often be of little importance.

In practice, similarly, the definition of supplementary means of interpretation will

often be of little importance – and attempts to define them may indeed gain nothing. No doubt for this reason, Article 32 does not define supplementary means of interpretation – beyond confirming that the preparatory work of a treaty and the circumstances of its conclusion are, in any event, included. The absence of such a definition matters little – because *any* material which elucidates the meaning of a treaty term will, by definition, be a means of interpretation (see Chapter 4.04). It is difficult to avoid the conclusion that, in practice, material must simply aid interpretation in order to rank as a (supplementary) means of interpretation.

As Sinclair commented (1984, 117): “The would-be interpreter is still expected, when confronted with a problem of treaty interpretation (which, *ex hypothesi*, involves an argument as to the meaning of a text) to have recourse to all the materials which will furnish him with evidence as to what is the meaning to be attributed to the text; such materials will naturally include the *travaux préparatoires* of the treaty, and the circumstances of its conclusion. It is only when he has available to him all the necessary materials that he will be in a position to assess their relative value and weight in the light of the rules laid down in the Convention.”

It can therefore be assumed that the Vienna Convention and its ILC Commentary do not define supplementary means of interpretation because any definition might only lead to the exclusion of relevant material. This is the reason the ILC gives for not defining *travaux préparatoires* (negotiating history) – see Chapter 22.01.

It is noteworthy that the circumstances in which Article 32 permits recourse to be had to supplementary means of interpretation are very similar to the first circumstance in which the House of Lords in *Pepper v. Hart* held recourse could be had to a UK statute’s legislative history – see Chapter 25.03. This demonstrates the relevance of the Vienna Convention approach to treaty interpretation at a (UK) domestic level.

21.02 *The more prestigious the supplementary means of interpretation, the more weight it should be given*

The fact that material may rank as supplementary means of interpretation does not mean that all material should be given the same weight. Thus in *Fothergill* (see Chapter 3.13) Lord Scarman commented ([1981] A.C. 294): “... the court must first look at the terms of the convention as enacted by Parliament. But, if there be ambiguity or doubt, or if a literal construction appears to conflict with the purpose of the convention, the court must then, in my judgment, have recourse to such aids as are admissible and appear to it to be not only relevant but helpful on the point (or points) under consideration. Mere marginal relevance will not suffice: the aid (or aids) must have weight as well.”

This comment by Lord Scarman was approved by Northrop J. in Australia: August 22 1990 *Thiel* (Article 7; 89 ATC 4,021 and 4,022).

Lord Scarman continued ([1981] A.C. 294 and 295): “A great deal of relevant material will fail to meet these criteria. Working papers of delegates to the conference, or memoranda submitted by delegates for consideration by the conference, though

relevant, will seldom be helpful: but an agreed conference minute of the understanding upon the basis of which the draft of an article of the convention was accepted may well be of great value. ...

The same considerations apply to the international case law and the writings of jurists. The decision of a supreme court, or the opinion of a court of cassation, will carry great weight: the decision of an inferior court will not ordinarily do so. The eminence, the experience and the reputation of a jurist will be of importance in determining whether, and, if so, to what extent, the court should rely on his opinion. ...

To those who would say that there is a risk of our courts becoming burdened with an intolerable load if this material is to be available, I would reply that the remedy lies with the court. It need look at no more than it thinks necessary.”

21.03 *The good faith principle*

The Vienna Convention and its ILC Commentary do not address the issue of whether different weight should be given to different supplementary means of interpretation at a public international level and, if so, what principles should govern. However, several (additional) principles can be deduced.

The good faith principle, which applies at both a public international level and a domestic level, is that a bilateral tax treaty should be interpreted in accordance with the common intention of *both* States – see Chapter 5. Whilst this intention is best found in the text, supplementary means of interpretation (indicating these intentions) can clarify the meaning of this text.

Accordingly, bilateral agreements (expressing both States' views) should normally be given greater weight than one State's pronouncements – because one State's unilateral interpretation may not be shared by its treaty partner State. Similarly, unilateral material which purports to express the views of both States should normally be given greater weight than unilateral material expressing the views of only one State.

Thus, Switzerland: *May 10 1989 Zurich Commission* (Article 15) held that because the words “temporarily present” were undefined in the 1951 US tax treaty (which did not contain a provision comparable to Article 3(2) of the 1977 OECD Model – see Chapters 10.13 and 20.04), they were to be interpreted in accordance with public international law and the intentions of the Contracting States. The Commission accordingly felt free to consider a Swiss Federal Circular which was expressed to reflect the intentions of both Contracting States.

As regards the weight to be given to unilateral material, McNair commented (1961, 421 and 422, footnotes omitted): “*Coming from a unilateral source.* Among other safeguards that might be attached to the practice of admitting evidence of preparatory work it is believed that it would be provident to exclude evidence of unilateral preparatory work. Surely whatever value there may be in preparatory work is that it may afford evidence of the common intention of the parties, as might in some circumstances be said of an earlier draft discussed by both parties or an exchange of letters between them. It is quite another thing to permit one party to produce, for

instance, a report made by its own representatives to their own Government during the negotiations as to what they understood a provision in a treaty to mean, or indeed a report made by the representatives of the other party to their own Government, unless such reports were contemporaneously communicated to the other party.”

21.04 *The adequate publicity principle*

This adequate publicity principle flows from the aforementioned good faith principle – and McNair hints at it at the end of the quotation in the preceding paragraph.

At a public international level, the publicity principle is that no supplementary means of interpretation can be invoked against a State which could not have been aware of it. Adequate publicity is acutely important as regards *travaux préparatoires* (preparatory work of the treaty). As regards multilateral treaties, Sinclair notes (1984, 144) that the only *travaux préparatoires* which can be taken into account are those “in the public domain so that States which have not participated in the drafting of the text should have the opportunity of consulting them. *Travaux préparatoires* which are kept secret by the negotiating States should not be capable of being invoked against subsequently acceding States. [*Footnote 113* runs in edited form: Yasseen 1976, 89-90.]”

At a domestic level, where taxpayers are involved, this publicity principle is that supplementary means of interpretation (including any competent authority agreements – contemporaneous or subsequent) should not generally be accorded *any* weight unless they have received adequate publicity. An agreement between competent authorities involving a tax treaty may be published as a Joint Statement – perhaps following a meeting of a Mixed or Joint Commission. However, it may often merely amount to an unpublicised ad hoc informal agreement, reached on a case by case (“specific case”) basis. At a domestic level, any such agreements which have not received adequate publicity should be given no more weight than any other Government argument.

Thus, France: *February 16 1990 CE* (Article 24 and Chapter 27.12) refused to give any weight to a subsequent competent authority agreement – because it had not received adequate publicity. Although the French tax authorities had published this agreement as an Instruction, they had not published it in the *Journal Officiel*.

The 1992 ALI Report considers (47) that (joint) publicity must be “in an officially recognized form, such as an exchange of notes or a memorandum of understanding”.

This Report also raises the possibility that unpublished material should be excluded from the interpretative process. It comments (48): “In order to protect taxpayer interests in an “objective” interpretation of treaty terms, it would seem appropriate to require that asserted agreements as to the meaning of the terms be public; unpublished documents should be given substantially less weight than published material or even excluded from the interpretative process.”

The 1992 ALI Report’s reluctance to whole-heartedly recommend the exclusion of unpublished material may reflect insufficient appreciation of the fact that a tax treaty may have to be interpreted differently at a public international level, and at a domestic level. However, it may also reflect a fact which this Report certainly does appreciate –

that even an unpublished competent authority agreement may be conclusive as regards a taxpayer who has become aware of it and who has reasonably relied upon it. Such a taxpayer could claim that a tax authority should be estopped from reneging on a joint agreement (see Chapter 27.29) or a unilateral ruling (see Chapter 28.19 onwards).

21.05 *The contemporaneity principle*

Another principle governing the weight to be given to supplementary means of interpretation is that of contemporaneity. Contemporaneous material (including background material available to the parties at the time they negotiated a tax treaty) should normally be given greater weight than subsequent material arising after a tax treaty has been negotiated. Contemporaneous material is the only material which can incontrovertibly evidence the parties' intentions at the time they negotiated a tax treaty. At this time, subsequent material cannot, by definition, have been considered by the negotiators of a tax treaty – and cannot form part of its context (let alone its text). However, this principle is less important at a public international level than at a domestic level – because States can subsequently agree, as between themselves, what they meant when they signed a tax treaty years earlier (see Chapter 16.01).

At a domestic level, in contrast, such a subsequent agreement may not have the force of law – see Chapter 27. Nevertheless, the principle that contemporaneous and background material should normally be given greater weight than subsequent material should not be applied blindly. Subsequent material may often be a more helpful means of interpretation than background material. Furthermore, contemporaneous and subsequent material may, with the passage of time, evolve into background material as regards later tax treaties – notably successor tax treaties (see Chapter 23).

21.06 *Any combination of these principles may need to be applied*

The principles outlined above may need to be applied in combination. For example, unpublicised practice by a single State (with little tax treaty awareness) long after a tax treaty has been negotiated should be given no more weight than any other Government argument – see Chapter 28.03.

21.07 *Two additional recommendations at a domestic level*

When a tax treaty is being interpreted at a domestic level, two additional recommendations must be considered. Firstly, tax authorities should be estopped from reneging on bilateral agreements and unilateral rulings – even though none of this material may have the force of law. Estoppel is discussed principally in relation to subsequent unilateral rulings – see Chapter 28.19 onwards.

Secondly, bilateral agreements and unilateral rulings issued in anticipation of litigation should be given no more weight than any other Government argument. Domestic courts in several States have disregarded unilateral Rulings issued in anticipation of litigation – see Chapter 28.18.

The 1992 ALI Report contains both the above recommendations (see Chapter 28.19

as regards estoppel and Chapter 28.03 as regards pre-litigation rulings) – but limits their scope to unilateral rulings.

It is possible that, were the ALI to (re-)focus on this possibility, it would also recommend estoppel as regards bilateral agreements – see Chapter 27.29.

However, my recommendation that bilateral agreements issued in anticipation of litigation should be given no more weight than any other Government argument seems to conflict with the 1992 ALI Report's view that they are generally conclusive. But this ALI view is not universal – see Chapters 16.03 and 27. For example, White (1991, 35) has advanced powerful reasons why, in UK: February 9 1990 *Commerzbank*, Mummery J. was correct to refuse to take account of the UK/US competent authority agreement in US: January 12 1977 Release IR-733 (both Article 7) – see Chapter 27.17.

Chapter 22 Travaux préparatoires – bilateral negotiating history

Article 32 of the Vienna Convention begins: “Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty ...”

The weight which should be given to travaux préparatoires becomes clearer, as always, if this issue is considered at two levels – the public international level and the domestic level.

22.01 Travaux préparatoires (negotiating history) at a public international level

Article 32 specifically includes the preparatory work of the treaty (*travaux préparatoires*) as supplementary means of interpretation.

Para. 20 of the ILC Commentary begins (italics added): “The Commission did not think that anything would be gained by trying to define *travaux préparatoires*; indeed, to do so might only lead to the possible exclusion of relevant evidence.”

At a public international level, little is gained by trying to define precisely what constitutes a tax treaty’s “*travaux préparatoires*” – because it is difficult to avoid the conclusion that, in practice, any borderline material which is relevant to the meaning of treaty terms will be “supplementary means of interpretation” – see Chapters 4.04 and 21.01.

22.02 The distinction between negotiating history and legislative history

At a domestic level, however, something is gained by trying to define *travaux préparatoires* – because it then becomes apparent that preparatory work on a tax treaty will often exist both at a (bilateral) public international level and, when a tax treaty is being incorporated into domestic law, at a (unilateral) domestic level.

To avoid confusion, I only use the term “*travaux préparatoires*” in its Vienna Convention sense of preparatory work at a public international level. This preparatory work can be equated to a tax treaty’s negotiating history. Thus in US: February 28 1989 *Stuart* (Article 26 and see Chapter 22.03) Justices Brennan and Scalia in the Supreme Court specifically described a tax treaty’s bilateral history (at an international level) as its “negotiating” history. This (bilateral) *negotiating* history, considered in this Chapter, must be distinguished from a tax treaty’s (unilateral) *legislative* history (or histories) at a domestic level – considered in Chapter 25.

Once a bilateral tax treaty’s text has been agreed by its negotiators, its negotiating history will typically be over – though see the comments in relation to the US below. When such a tax treaty then has to be brought into the force domestically in a State, it will typically acquire a legislative history in this State.

If some legislative history is generated in each State (which will not always be the case), a bilateral tax treaty will have three histories – one (bilateral) international negotiating history and two (unilateral) legislative histories; a multilateral tax treaty will have a negotiating history and as many legislative histories as it has signatories.

Although the distinction between a tax treaty's (bilateral international) negotiating history (*travaux préparatoires*) and its (unilateral domestic) legislative histories in each treaty State is important, it can become blurred. For example, it is a feature of the US treaty-making process that the US can take a second "look" at a tax treaty after it has been negotiated – see Chapter 25.04. This gives the US an opportunity to amend or re-negotiate a tax treaty. It may also lead to the incorporation of part or all of a tax treaty's US legislative history into its negotiating history – especially if the US decides that it does not like what it sees on its second (or any subsequent) look.

Furthermore, if State A specifically agrees with an interpretation generated in the course of a tax treaty's legislative history in treaty partner State B, State B's courts may hold that this State B interpretation has become, effectively, bilateral. Unsurprisingly, holdings to this effect have been made by US domestic courts in relation to US legislative history. More remarkably, courts in other States have given weight to *a treaty partner State's* unilateral legislative history – see Chapter 25.13; this evidences the willingness of some courts to interpret tax treaty terms on a consistent, reciprocal basis – in line with the treaty partner State's approach (see Chapter 5).

22.03 Evidence of *travaux préparatoires*

The importance of distinguishing between the interpretation of a tax treaty at a public international level, and at a domestic level, becomes clear when one focuses on what weight should be given to *travaux préparatoires*.

At a public international level, for example, any preserved treaty drafts may be very relevant in determining the meaning of the treaty text. Successive drafts (available to both States) may clearly demonstrate the evolution of rough drafts into the final agreed text – and clarify its meaning. *As between the Contracting States themselves*, these *travaux préparatoires* may be invaluable evidence. Even if not available to the public, this material will be available to the only persons who matter at this public international level – the Contracting States themselves.

At a domestic level, however, quite different considerations apply – because tax treaty negotiations between competent authorities are often conducted in some secrecy. Typically, these negotiations are not made public even when the tax treaty is being considered by domestic legislative bodies – so that its negotiating history never becomes part of its legislative history. For this reason, Justice Brennan (in his Supreme Court majority opinion in US: February 29 1989 *Stuart* – Article 26 and see Chapter 25.11) considered legislative history to be more valuable than negotiating history. He commented (103 L Ed 2d 405 Footnote 7): "A treaty's negotiating history, which Justice Scalia suggests would be a better interpretive [*sic*] guide than preratification Senate materials, see post, at – , 103 L Ed 2d 409, would in fact be a worse indicator of a treaty's meaning, for that history is rarely a matter of public record available to the Senate when it decides to grant or withhold its consent."

Because tax treaty negotiations are rarely made public, taxpayers cannot be aware of them – and, accordingly, should not be bound by them.

In *Fothergill* (see Chapter 3.13) Lord Wilberforce commented ([1981] A.C. 278B) that consideration could only be given to travaux préparatoires where they were “public and accessible”. Similarly, Lord Fraser of Tulleybelton, in a passage which (although arguably *obiter*) is most relevant to tax treaties, commented ([1981] A.C. 287 and 288): “It may be legitimate for English courts, when construing an Act of Parliament which gives effect to an international agreement, to make cautious use of the travaux préparatoires for the purpose of resolving any ambiguity in the treaty: see *Black-Clawson International Ltd. v. Papierwerke Waldhof-Aschaffenburg A.G.* [1975] A.C. 591, *per* Lord Diplock, at p. 640. Even if that be so, we are in this case being invited to go a stage further and I for my part would decline to do so. We were invited to refer to the minutes of the Hague Conference of 1955, at which the Protocol to amend the Warsaw Convention of 1929 was agreed, for the purpose of finding there recorded an agreement between the states represented at the conference that “damage” in article 26(2) was to be construed as including partial loss. It was said to be the duty of British courts to give effect to the alleged agreement. I shall assume, for the moment, that such an agreement is recorded in the minutes, although in fact I do not think it is. Making that assumption, I am of opinion that we should decline to give effect to the alleged agreement or to take judicial notice of it, because it has not been sufficiently published to persons whose rights would be affected by it, such as Mr. Fothergill, the respondent. They ought to be entitled to rely on the texts, English and French, scheduled to the Act, without finding that the meaning of the text is controlled by some extraneous agreement of which they have no notice. If the meaning of an expression in an Act of Parliament, giving effect to a treaty which directly affects the rights of private citizens, has been defined by some extra-statutory agreement between the British government and other governments, I do not think the definition ought to be applied as part of English law unless it has been published to the same extent as the Act, as if it were an interpretation clause in the Act, which is what in substance it is. True, the minutes of the Hague Conference were published by the International Civil Aviation Organisation in 1956, in English, French and Spanish, and were on sale at Her Majesty’s Stationery Office. Whether they are (or were in March 1975) still obtainable there I do not know, though I have my doubts. In any event, they have never been as readily accessible as the Act itself and in my opinion they have never been reasonably accessible to private citizens, or even to lawyers who do not happen to specialise in air transport law. To treat an agreement buried in such material as capable of containing a binding definition of an expression in a statute, seems to me to offend against the basic principle that: “It is requisite that this resolution [of the legislator] be notified to the people who are to obey it” – *Blackstone’s Commentaries*, 21st ed. (1844), vol. I, p. 45.”

Also in *Fothergill* Lord Diplock commented ([1981] A.C. 279): “Elementary justice or, to use the concept often cited in the European Court, the need for legal certainty demands that the rules by which the citizen is to be bound should be ascertainable by him (or, more realistically, by a competent lawyer advising him) by reference to identifiable sources that are publicly accessible.”

Lord Diplock's comment was implicitly approved ([1992] STC 917) in the UK House of Lords in *Pepper v. Hart* by Lord Browne-Wilkinson – who held that it was permissible for UK legislative history (see Chapter 25.03) to be given effect because ([1992] STC 920d): “It is possible to obtain parliamentary materials and it is possible to trace the history. The problem is one of expense and effort in doing so, not the availability of the material.”

The 1992 ALI Report takes a slightly different view. After citing (48, Footnote 155) this same remark by Lord Diplock in *Fothergill*, it comments (58, Footnote 176 edited): “The Institute has previously expressed a strong preference for relying on published materials or interpretative sources. This is a matter of fairness to taxpayers; [Footnote 176 refers again to this remark by Lord Diplock] but, more importantly perhaps, unpublished materials have not been subjected to public scrutiny and comment and therefore may represent a less reliable analysis. Nevertheless, reference to these materials should not be precluded at least when more persuasive sources are not available.”

The less the weight which domestic courts give to a tax treaty's non-public negotiating history, the more likely it is that the secrecy surrounding tax treaty negotiations will be relaxed. Practitioners have long argued for greater disclosure in this area. For example, over a decade ago Langer called (1978, 751) for greater public disclosure and involvement (both during a tax treaty's negotiation and after the announcement of its proposed terms) in relation to the comparatively public US treaty-making process. Langer's call for “government in the sunshine” in this area could be echoed in the many States where tax treaties are negotiated and concluded in even greater secrecy – allegedly, to gain negotiating advantages. It would be ironic, albeit unsurprising, if tax authorities now decided to relax such secrecy – simply because this may be in their interests. Only by relaxing such secrecy can they endow a tax treaty's negotiating history with any significant weight at a domestic level.

22.04 Publicly available negotiating history

If a taxpayer does become aware of a tax treaty's negotiating history, he may invoke it to his advantage – possibly on the grounds of estoppel.

In Germany: *February 19 1975 BFH* (Article 10) one issue was whether shares in a German company held by members of a Netherlands fiscal unit could be attributed to another of its members, a Netherlands company (“N”). N argued that shares which it owned “indirectly” could not be allocated to it – because, under Article 13 of the 1959 Netherlands tax treaty, ownership had to be direct.

The BFH held that this treaty gave no indication that the parties intended the law of the State where a company was resident to govern this issue. Accordingly, the issue of whether German withholding tax was due should be governed by German domestic law – which precluded the shares being allocated to the Netherlands company, because it did not own them directly.

N also alleged that the German treaty negotiators had refused their Netherlands

counterparts' request for the treaty to define ownership so as to encompass indirect, as well as direct, ownership. In making its decision, the BFH noted that the German tax authorities did not deny this allegation.

22.05 The evidence of individual negotiators and other experts

At both public international and domestic levels, there are several reasons why "evidence" as to the negotiating history of a tax treaty should be treated with caution.

Firstly, isolated "snapshot" evidence on negotiations at one particular time may be unreliable – because it will only illustrate a phase or aspect of these negotiations (which may take place over several years, and which may involve different negotiators at different times). Even the same negotiator's ostensible position may change, perhaps deliberately, during the course of negotiations.

Secondly, evidence on negotiations will typically only be available from individuals who were on a competent authority negotiating team. These individuals may still be negotiating for their State – or have less obvious conflicts of interest.

Thirdly, any evidence by individuals will typically be subjective – and may be based solely on personal notes and/or recollections.

The 1992 ALI Report therefore recommends (51): "5. In the interpretation of a treaty term, little or no weight should ordinarily be given to evidence of individual treaty negotiators ...". This Report comments (51 and 52, footnotes omitted): "While a negotiator certainly is in a position to know what transpired in the course of the negotiations, his or her recollections or recordings of events may not reflect a consensus of those participating, even on behalf of one country, much less the other. Moreover, a "battle of experts", in which a court or other tribunal attempts to sort through the testimony of negotiators (who, in the US at least, may have long since turned to other occupations) seems a time-consuming and unreliable way to arrive at a sound interpretation."

At a domestic level, there is an all-important reason why evidence relating to a tax treaty's negotiating history should normally be excluded from consideration: none of this history will normally have been made public (see Chapter 21.04).

However, US courts have considered experts' evidence. For example, in US: March 17 1988 *Xerox* (Article 23) Xerox submitted affidavits from two former members of the US team which negotiated the 1975 UK tax treaty. They gave their views as to the intent of the US and UK negotiators in 1975. They also gave brief comments on the US Technical Explanation to this treaty, and on internal US government memoranda summarising meetings held at the Treasury (in 1977, to discuss the Technical Explanation) and at the IRS (in 1980, to discuss Rev. Proc. 80-18).

Futey J. considered these affidavits – but held that they could not take precedence, as evidence of the intent of the treaty partners, over the US Treasury's Technical Explanation and other US and UK official announcements (all of which had been published). However, he did rely (crucially – and incorrectly, see Chapter 25.10) upon evidence from these former negotiators that copies of the US Technical Explanation

had been sent to the UK Inland Revenue.

In US: August 13 1992 *Snap-On* (Article 23) the plaintiff successfully submitted the affidavit of the late Robert J. Patrick – who was International Tax Counsel at the US Treasury from 1973 until the summer of 1976. According to his affidavit, Mr. Patrick was a leader of the US team which negotiated the 1975 tax treaty. Horn J. accorded weight to this Patrick affidavit.

In *Snap-On* the IRS also submitted a statement by Paul J. Oosterhuis and David Brockway; the former was the Legislative Counsel to the US Joint Committee of Taxation, the latter was the Legislative Attorney to the US Senate Foreign Relations Committee. Horn J. did not find that their statement lent much support to the IRS position – but he did consider it.

22.06 Evidence on the history and evolution of tax treaty terms

Although an individual's evidence as to negotiations should not normally be given weight, evidence by an expert (who could be a negotiator) on a tax treaty's international history or evolution, rather than on its negotiation, may be valuable. Such evidence can describe the circumstances of tax treaty's conclusion – see Chapter 26.01, notably in relation to Canada: September 7 1979 *Hunter Douglas* (Article 10).

Chapter 23 International circumstances of a tax treaty's conclusion

Article 32 of the Vienna Convention begins: "Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion ..."

23.01 *The circumstances of a tax treaty's conclusion*

Article 32 specifically includes "the circumstances of [a treaty's] conclusion" as supplementary means of interpretation.

At a public international level, the circumstances of a tax treaty's conclusion should only comprise those circumstances which all (i.e., typically, both) treaty partner States were aware of. Such circumstances will of course include international law at that time, notably the *pacta sunt servanda* principle – see Chapter 5.

At a domestic level, similarly, only those circumstances which were publicly available when a tax treaty was being concluded should be given weight – see Chapter 21.04. These circumstances will typically consist of a tax treaty's international or historical background (discussed in this Chapter) and its domestic fiscal background in each State (discussed in Chapter 24). Existing jurisprudence and doctrine may also form part of these domestic circumstances; however, because these materials typically post-date a tax treaty, they are discussed in Chapters 29 and 30 respectively.

23.02 *The history and evolution of tax treaty terms*

Article 31 of the Vienna Convention requires treaty terms to be interpreted in their context – see Chapter 7.01. Tax treaty terms, expressed in international tax language, must therefore be interpreted in their international tax treaty context – or, to put it another way, in the light of their background. As Willis commented (1938, 9): "In the case of words with double meanings, or words bearing complex connotations the background is naturally and necessarily of decisive importance. ... The paramount influence of background does not stop there: it colours and controls the force even of words whose meaning is ordinarily single and precise."

To illustrate the history and evolution of tax treaty terms, counsel (on both sides) now routinely refer to material which existed at the time the tax treaty in issue was concluded, such as OECD Models and Commentaries, predecessor tax treaties, tax treaties with third States, jurisprudence and doctrine.

23.03 *The League of Nations draft tax treaties*

Domestic courts have long recognised that the historical background of a tax treaty's terms forms part of the circumstances of its conclusion. In US: November 1 1946 *Kimball* (Article 18) Arundell J. in the Tax Court, interpreting the 1932 France tax treaty (the first general income tax treaty concluded by the US – see Chapter 12.01), analysed the genesis of double tax treaties and the different drafts prepared by the League of Nations.

Arundell J. commented (6 T.C. 537 and 538): “In the years following the first World War the problem of international double taxation grew to serious proportions. Both the International Chamber of Commerce and the League of Nations became alarmed over the paralyzing effect of the problem on international trade, and each appointed committees for the purpose of formulating solutions and developing uniform principles. The committees of the two organizations cooperated. In 1927 the League of Nations Committee of Technical Experts on Double Taxation and Tax Evasion submitted a report of their studies and a model bilateral convention on double income taxation, based at least in part upon principles garnered from existing treaties between various European countries. [*Footnote 2: Double Taxation and Tax Evasion – Report Presented by the Committee of Technical Experts on Double Taxation and Tax Evasion, League of Nations Document, C.216, M.85 1927. II. 40.*] This model draft was thereupon sent by the League to the governments of various members and nonmember States, and in 1928 a meeting of government experts from 27 countries, including the US and France, was convened at Geneva for the purpose of discussing the technical experts’ recommendations and preparing other model texts. The meeting of government experts adopted, with some modifications, the draft recommended by the technical experts and in addition formulated two other model texts, designated as draft conventions Nos. 1a, 1b, and 1c in their report. [*Footnote 3: Double Taxation and Tax Evasion – Report Presented by the General Meeting of Government Experts on Double Taxation and Tax Evasion, League of Nations Document, C.562, M.178. 1928. II.*] As a result of the work of the League and the International Chamber of Commerce committees, “uniform definitions were being formulated, the predominant kinds of income were being classified, and an international tax language was being developed.” [*Footnote 4 runs in edited form: Carroll 1935, 588.*]

Subsequent to the adoption of the draft conventions by the meeting of government experts, a number of bilateral conventions embodying the provisions of the drafts were entered into between various European countries.”

In a 1931 Report, the League of Nations Fiscal Committee focused on the possibilities of plurilateral conventions. In 1933 this Fiscal Committee submitted a Draft Convention for the Allocation of Business Income between States for the Purposes of Taxation.

Those wishing to research the above history further should refer to Wang (1945).

In the 1940s, under the aegis of the League of Nations, two new draft conventions were drawn up – the 1943 Mexico Draft (which Latin American States influenced and which emphasized the taxing rights of source States) and the 1946 London Draft (which European States influenced and which emphasized the taxing rights of residence States). Neither draft achieved worldwide support; they are briefly discussed by Brabson (1951).

23.04 *The OEEC/OECD drafts*

After World War II, international trade accelerated – making the avoidance of double

taxation more pressing. In 1956 the OEEC (Organisation for European Economic Cooperation) established a Fiscal Committee. This Committee (which became the OECD Committee on Fiscal Affairs in 1971) began to draft a tax treaty which would be acceptable to all Member States. Between 1958 and 1961 it produced four interim reports. On September 30 1961, when Canada and the US became members, the OEEC became the OECD (Organisation for Economic Cooperation and Development).

The original OECD Member countries are Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, the UK and the US.

Japan became a Member on April 28 1964, Finland on January 28 1969, Australia on June 7 1971 and New Zealand on May 29 1973. Mexico became a Member on April 14 1994. On June 8 1994 the OECD announced that Korea could become a Member by the end of 1996, and called for “an early start” on negotiations to admit the Czech Republic, Hungary, Poland and Slovakia.

In 1963 the OECD Fiscal Committee produced its “Draft Double Taxation Convention on Income and Capital” (the 1963 OECD Draft). The Articles in the 1963 OECD Draft were supplemented by Commentaries. Both the Articles and the Commentaries were approved by the OECD Council. However, as Patrick observed (1978, 613 Footnote 1): “The US participated only briefly in the preparation of the 1963 OECD Model.” Only in the late 1960s did the US begin to adopt this 1963 OECD Draft as what Guttentag and Miyatake have described (1993, 170) as “a guide, if not a model” for tax treaty negotiations. The influence of the 1963 OECD Draft on US income tax treaties has been well described by Lazerow (1976).

Fourteen years elapsed between the publication of the 1963 OECD Draft and its successor, the 1977 OECD Model. In those years this Draft was increasingly used as the starting point for tax treaty negotiations between OECD Member States. Tax treaty provisions adopting its wording far exceeded those deviating from it.

In 1972 and 1974 the OECD Committee on Fiscal Affairs published provisional Revised Drafts (with Revised Commentaries) of several Articles in the 1963 OECD Draft. These Revised Drafts, which were not specifically approved by the OECD Council, began to reflect US influences – see Chapter 26.06.

23.05 Other tax treaty initiatives

In November 1971 the Commission of the Cartagena Agreement adopted two Andean Pact Model Conventions, one for use between members and the other for use between a member and a non-member. The Cartagena Agreement originally involved Bolivia, Chile, Colombia, Ecuador and Peru; Chile then left and Venezuela joined.

In November 1972 Denmark, Finland, Iceland, Norway and Sweden concluded their Nordic income tax Convention – which has been amended or replaced several times, notably in 1983, 1987 and 1989 (when the Faroe Islands became a signatory).

Multilateral Nordic Conventions on estates and gifts taxes, and on mutual assistance, now also exist. Williams has commented (1991 Para. 436) that these income and estate

tax treaties “show the strong influence of the bilateral treaties that they replaced, and, behind them, the work of the OECD of which all five States are members. There are no major new concepts or approaches in these agreements which in some clauses resort to lists to cover the differences between the treaty partners.”

In 1976 a Group of Experts of the Latin American Free Trade Association (LAFTA) adopted proposals for the avoidance of double taxation.

Because they may be wider than analogous tax treaty provisions, several EU measures must also be considered when tax treaties are being interpreted, As regards arbitration, see Chapter 2.05; as regards non-discrimination, see UK: April 12 1991 *Commerzbank* (Article 24 and Chapter 12.13) and its *Editorial* on July 13 1993 *ECJ*.

In the future, more tax treaty Models may emerge – possibly as a result of regional initiatives in the Pacific Basin (see Vann 1991) or NAFTA (see McDaniel 1993).

23.06 *The 1977 OECD Model*

In April 1977 the OECD Committee on Fiscal Affairs produced the “Model Double Taxation Convention on Income and on Capital” (the 1977 OECD Model).

In producing the 1977 OECD Model, the OECD Committee on Fiscal Affairs further revised the 1963 OECD Draft, and the 1972 and 1974 provisional Revised Drafts. Much of this revision was carried out by this Committee’s Working Party No. 1 on Double Taxation and Related Matters. Other Working Parties to this Committee also contribute to this process, notably Working Party No. 6 on Taxation and Multinational Enterprises and Working Party No. 8 on Tax Avoidance and Evasion. In the words of the 1992 OECD Special Notice accompanying the publication of the OECD Model, the 1977 Model “was the culmination of a long process of revision” of the 1963 Draft.

Since its publication, the 1977 OECD Model has also been followed closely by Member States and other States (re)negotiating tax treaties.

23.07 *The 1979 UN Model*

In 1967 the Economic and Social Council of the United Nations set up the “UN Group” (the UN Group of Experts on Tax Treaties Between Developed and Developing Countries). One of the UN Group’s tasks was to facilitate the conclusion of tax treaties between developing and developed countries. Developing countries felt that they might be better served by a Model favouring capital-importers to a greater extent than Models from the OECD (most of whose Member States are capital-exporters). Nevertheless, because the 1963 OECD Draft was being increasingly used by OECD Member States, the UN Group used it (in the words of Professor Stanley S. Surrey – 1980, 7) as “a reference for orderly discussion”.

Revisions to the 1963 OECD Draft were made available to the UN Group whilst it prepared its own Model and Commentaries. This work culminated in a 1979 UN Model tax treaty and Commentary. Although these UN materials seek to express the view of capital-importing developing States (see IFA 1979), they follow their 1977 OECD Model analogues very closely (save that the 1977 OECD Model has one additional

Article 28 – Territorial Extension). The 1979 UN Commentary gives reasons for the differences between the wording of the 1979 UN Model and the 1977 OECD Model.

23.08 *The 1977 and 1981 US Model tax treaties*

On May 18 1976 the US Treasury Department (in News Release WS-861) published a draft model tax treaty – analysed by Bissell (1977). On May 17 1977 the US published a revised model tax treaty (the 1977 US Model).

This 1977 US model (which contains no Commentary) deliberately resembles the 1977 OECD Model – but it also contains significant deviations. Patrick commented (1978, 615): “Among policy decisions that result in a departure from the OECD Model are the inclusion of several rules designed to deal with perceived abuse of tax treaties, somewhat greater emphasis upon reduction or elimination of tax at source, greater emphasis upon spelling out source of income rules, and different concepts as to the threshold rules for taxation of independent personal service income, rental income from equipment leasing, and auxiliary or preparatory activities under the permanent establishment concept.”

The 1977 US Model was then replaced by a June 16 1981 US Model (the 1981 US Model). On December 23 1981 an additional draft of Article 16 of this 1981 US Model was published. All these US Models have been compared by Shannon (1986).

A June 17 1992 Treasury News Release withdrew the 1981 US Model, and forecast that it would soon be replaced by a new Model with a Technical Explanation. Changes consequent upon President Clinton’s election, and the need to focus on more pressing international tax issues, have delayed this oft-mooted project.

A discussion draft of a new US Model is now scheduled to appear later in 1994.

23.09 *The 1987 Netherlands Model tax treaty*

On December 3 1987 the Netherlands released a model tax treaty. It resembles the 1977 OECD Model even more closely than the 1981 US Model, and was the subject of detailed Parliamentary questioning – see van Raad (1988, 241) and van Waardenburg (1988, 108).

23.10 *OECD tax treaty publications between 1977 and 1989*

Between 1977 and 1989 the OECD Committee on Fiscal Affairs published several Reports involving tax treaties. All these (and other) OECD Reports are available from the OECD, 2 rue André Pascal, 75775 Paris Cedex 16, France. The OECD had kindly given permission for extracts from its Reports to be reproduced in *The International Tax Treaties Service*, where they typically appear in the *Editorials* on the appropriate Articles.

The first OECD Report (in 1979) was *Transfer Pricing and Multinational Enterprises* (the 1979 OECD *Transfer Pricing* Report). It was supplemented (in 1984) by *Transfer Pricing and Multinational Enterprises – Three Taxation Issues* (the 1984 OECD *Transfer Pricing* Report). The three Issues are (i) Transfer Pricing,

Corresponding Adjustments and the Mutual Agreement Procedure (the 1984 OECD *Mutual Agreement Report*), (ii) The Taxation of Multinational Banking Enterprises (the 1984 OECD *Multinational Banking Report*), and (iii) The Allocation of Central Management and Service Costs (the 1984 OECD *Allocation of Costs Report*).

The second OECD Report (in 1981) was *Model Convention for Mutual Administrative Assistance in the Recovery of Tax Claims* (the 1981 OECD *Mutual Assistance Model*). This Model formed the basis of an OECD-inspired Council of Europe production, namely the *Convention on Mutual Administrative Assistance in Tax Matters* (the 1988 OECD/EEC *Mutual Assistance Convention*). This Convention was opened for signature on January 25 1988.

In 1985 three further OECD Reports were published under the title *Trends in International Taxation*. These three Reports are (i) The taxation of income derived from the leasing of industrial, commercial or scientific equipment (the 1985 OECD *Equipment Leasing Report*), (ii) The taxation of income derived from the leasing of containers (the 1985 OECD *Container Leasing Report*), and (iii) Taxation issues relating to international hiring-out of labour (the 1985 OECD *Hiring-out of Labour Report*).

1987 marked a new OECD series: *Issues in International Taxation* (the *Issues* series).

Report No. 1 in this *Issues* series is *International Tax Avoidance and Evasion – Four Related Studies*. The Four Related Studies are (i) Tax havens: measures to prevent abuse by taxpayers (the 1987 OECD *Tax Havens Report*), (ii) Double taxation conventions and the use of base companies (the 1987 OECD *Base Companies Report*), (iii) Double taxation conventions and the use of conduit companies (the 1987 OECD *Conduit Companies Report*), and (iv) Taxation and the abuse of bank secrecy (the 1987 OECD *Bank Secrecy Report*).

Report No. 2 in this *Issues* series, also published in 1987, covers *Thin Capitalisation* (the 1987 OECD *Thin Capitalisation Report*) and *Taxation of Entertainers, Artists and Sportsmen* (the 1987 OECD *Entertainers Report*).

Report No. 3 in this *Issues* series, published in 1988, covers *Consequences of Foreign Exchange Gains and Losses* (the 1988 OECD *Exchange Gains and Losses Report*).

In 1989 the OECD de-restricted, but did not publish, a *Tax Treaty Override Report* (the 1989 OECD *Override Report*) – reproduced in Appendix I.

23.11 The (1992) OECD Model

In September 1992 the OECD produced a successor to its 1977 Model, the “Model Tax Convention on Income and on Capital” – the (1992) OECD Model.

This OECD Model makes few changes to the *text* of the 1977 OECD Model – only altering its title (see Chapter 11) and Articles 3, 12, 15, 17 and 24. However, it includes a number of changed Observations and Reservations by Member States – and makes many other changes to the Commentary. Most of these other changes follow recommendations in OECD Reports – some of which were published prior to the release of the (1992) OECD Model (see above) but some of which were only published

months later (see Chapter 23.12).

A 1992 OECD Special Notice accompanying the (1992) OECD Model describes it as “primarily a consolidation” of the 1977 OECD Model and these Reports.

23.12 OECD tax treaty publications from 1992 through June 1994

Various OECD Reports which the (1992) OECD Model refers to as having formed the basis for many of its changes were made publicly available some months later in Report No. 4 in the *Issues Series – Model Tax Convention: Four Related Studies*. These Reports are: (i) The 183 Day Rule: Some Problems of Application and Interpretation (the 1992 OECD *183 Day Rule* Report), (ii) Triangular Cases (the 1992 OECD *Triangular Cases* Report), (iii) The Tax Treatment of Software (the 1992 OECD *Software* Report) and (iv) The Tax Treatment of Employees’ Contributions to Foreign Pension Schemes (the 1992 OECD *Contributions* Report). It is unclear why these Reports or Studies are “related” – apart from the fact that, as the title of Report No. 4 indicates, they all deal with Model Tax Conventions.

On December 17 1992 the OECD Council de-restricted a report by a special Task Force of the Committee on Fiscal Affairs. This was published (in 1993) as *Tax Aspects of Transfer Pricing within Multinational Enterprises; the US proposed Regulations* (the 1993 OECD *Transfer Pricing* Report). Guttentag and Miyatake have commented (1993, 196) that the US “participated actively in the work of” this OECD Task Force and that: “Many of the changes in the 1993 [US] rules from the 1992 [US] proposed rules, which drew at least curt nods if not broad smiles from tax practitioners and foreign government officials, can be traced to the 1993 OECD report.”

Report No. 5 in the *Issues Series*, published in January 1994, is *Model Tax Convention: Attribution of Income to Permanent Establishments* (the 1994 OECD *Attribution* Report). This Report recommended changes to the (1992) OECD Model and its Commentary, and these have been incorporated in the (June) 1994 Update to the OECD Model.

23.13 The looseleaf OECD Model and future changes

The (1992) OECD Model is published in loose-leaf format. This will, as the 1992 OECD Special Notice comments (*italics added*): “... allow periodic updates, thereby ensuring that the text of the Model Convention and its Commentaries continually reflect *the current views* of the Member countries of the OECD.”

This Notice also comments: “The new format of the Model Convention reflects the fact that the revision of the Model Convention has become a permanent process.” In view of this, additional OECD Reports are also anticipated. This Notice comments: “These reports reflect changing economic circumstances as well as the experience gained by Member countries in applying the provisions of their tax conventions which are based on the OECD Model Convention.”

This looseleaf periodic updating approach to the OECD Model has drawbacks. As the current views of OECD Members change so, we are told, will the Commentary – on

Articles which, traditionally, have remained largely unchanged. Nothing is more likely to debase the value of this Commentary than constant changes reflecting the current views of OECD Members on what (largely unchanged) Articles should mean. To the extent possible, OECD Commentary should reflect eternal truth – not current views.

Revenue-raising considerations seem to have prompted the OECD to forbid immediate reproduction of the 1992 OECD Model and its Commentary. This has reduced the extent to which this material would otherwise have been publicised – and has thereby slightly reduced the considerable weight which this material can command at a domestic level. In the future, other Models in which no copyright is claimed (such as, say, a new US Model with a Technical Explanation) may therefore be reproduced in preference to OECD material.

For the time being, the OECD is the sole source of its own material – and it would be unfortunate if supposed revenue-raising considerations ever prompted the OECD to issue more updates than necessary. Updating material should only be issued after the most careful consideration – which has not always been evident in the past.

For example, the re-drafted 1992 OECD Commentary on Article 3(2) had a 15 year gestation period – yet some consider it so unsatisfactory that it will probably be re-drafted yet again (see Chapter 10.13). Even though this Commentary may be more satisfactory than some of the views expressed by its critics, it does seem to have been drafted by a Committee anxious to reflect all Governmental views – even conflicting views. Perhaps inevitably, acceptability to the largest possible number of OECD Members seems to have been of major concern. Commentary drafted in even greater haste may meet with an even less enthusiastic response – even if input is received from non-governmental advisers with appropriate skills.

Hopefully, the OECD will not lose sight of the fact that the primary aim of the OECD Models (and their predecessors) has always been to avoid the double taxation of taxpayers – and not to combat tax minimisation techniques. As Bartlett commented (1991, 85 footnote 25 omitted): “... the Fiscal Affairs Committee should be as much concerned with the protection of taxpayers, corporate and individual, from unfair or arbitrary taxation as with the protection of revenue authorities ...”

The OECD now explicitly welcomes suggestions on revisions to the OECD Model and its Commentaries. However, virtually none of the many suggestions made by Hund (1989) have been adopted, even though they consist largely of recommendations by the OECD’s Business and Industry Advisory Committee (BIAC) – which Messere (1993, 249) has described as the OECD’s “formal source for dialogue with the private sector”.

Messere (formerly in the OECD’s Fiscal Affairs Division) has commented (1993, 251): “Perhaps the time is now ripe for the OECD to pronounce more unambiguously on such matters as the legitimacy of treaty overrides, branch taxes, special treatment of super-royalties, and tax sparing as well as on the legal status of the Commentaries, the relevance of the Vienna Convention, the relation between domestic and treaty law, etc. There is also the question whether it should be made clear in the Articles of the Convention that the Commentaries are an integral part of the Model, for the courts of

OECD countries currently vary on the weight they accord to the Commentaries ...”

The 1994 Update to the (1992) OECD Model was foreshadowed in an unscheduled speech at the 1993 IFA Congress. The (January) 1994 OECD *Attribution* Report then covered some of these changes in more detail; its recommendations for change were then adopted in the 1994 Update. Other approaches may evolve.

23.14 *The importance of the OECD and UN Models*

The OECD Models have long been the most used starting points for tax treaty negotiators. They are yardsticks against which other tax treaties, or even comparable legislation, can be compared.

That the concepts embodied in OECD Models can transcend their context is illustrated by Germany: *November 13 1990 BFH* (Article 7), which involved a German corporation undertaking a construction project in the former East Germany (GDR).

At issue was the amount of profits attributable to this construction site (which constituted a permanent establishment). The BFH held that tax treaty principles should apply – even though no tax treaty existed between what was then East and West Germany. Accordingly, in line with Article 7(2) of the 1977 OECD Model, the profits attributable to the permanent establishment should be those “which it might be expected to make if it were a distinct and separate enterprise”.

23.15 *OECD and UN Models and the Vienna Convention*

Van Raad has suggested (1978, 16) that because OECD Commentary “has been arrived at in joint discussions between the member states who have been in a position to make reservations on its contents, it appears to be justified to recognise this Commentary as part of the context within the meaning of Article 31(2)(b) of the Vienna Convention.” As indicated in Chapter 15, Article 31(2)(b) covers “any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.”

In Australia: August 22 1990 *Thiel* (Article 7) Dawson J. also felt that OECD Commentary *has* to be considered as part of the *context* of a tax treaty – in line with Article 31 of the Vienna Convention. However, he noted that Avery Jones *et al.*, whilst accepting (1984, 92 and 93) that such OECD material is an instrument related to a treaty, had expressed doubts as to whether it could fall within Article 31(2)(b) – because it was not made “in connexion with the conclusion of the treaty”. Accordingly, Dawson J. simply invoked Article 32 of the Vienna Convention to enable him to consider this material – see Chapter 23.25.

I share the doubts expressed by Avery Jones *et al.* as to whether the OECD material can be considered as “made by one or more parties in connexion with the conclusion” of any tax treaty. Furthermore, I take the view that this material is neither an agreement (under Article 31(2)(a)) nor an instrument (under Article 31(2)(b)). OECD and UN Models and Commentaries are just that – models and commentary. As they themselves confirm (see Chapter 23.24), they are not treaties; nor are they part of a tax treaty’s

context as defined by Article 31(2) of the Vienna Convention – see Chapter 15.04.

23.16 OECD and UN Models and domestic law

OECD and UN Models and Conventions have never been enacted into any State's domestic law. Accordingly, this material has no legal force as a treaty at either a public international level or a domestic level. As the italicised words in Para. 26 of the Introduction to the 1977 OECD Model, Para. 3 of the Introduction to the 1979 UN Model and Para. 29 of the Introduction to the (1992) OECD Model (see Chapter 23.24) make clear, the only legally binding agreement (at least at a domestic level) is the *text* of a tax treaty.

Thus Belgium: *March 8 1988 Brussels CA* (Article 15) correctly holds that the 1977 OECD Model is only a recommended Model which has no domestic legal force – and rejected the argument that its Article 15(1) precluded a tax assessment.

Although OECD and UN Models have no legal force at a domestic level, they and their Commentaries are, as regards a subsequent tax treaty, clearly part of “the circumstances of its conclusion” (as envisaged by Article 32 of the Vienna Convention). Subsequent Models and Commentaries may also be useful means of interpretation – see Chapter 26. Accordingly, such material should be given considerable (but not excessive) weight. As Chapter 6 makes clear, tax treaty terms must be given the meaning they *do* have – not a meaning which may reflect the current views of the parties (let alone the OECD Committee on Fiscal Affairs).

The 1992 ALI Report comments (3 and 4, footnote 10 omitted): “The OECD Model Treaty therefore has come to have a special significance. Although it technically is not binding on any country, it has almost acquired the status of a multilateral instrument. Certainly, it would be wholly unrealistic to disregard the OECD Model and its accompanying Commentary in judging what should properly be included in a treaty or in ascertaining what treaty provisions mean.” This ALI Report makes comparable comments as regards the OECD Commentary – see Chapter 23.24.

23.17 Deviations from OECD or UN Models

Because OECD and UN Models have long been the most used starting points for tax treaty negotiators, deviations from them can be very significant. The fact that a tax treaty omits a provision in an earlier Model may be particularly significant – especially if this omission is accompanied by a Reservation on the Article by one (or both) of the treaty partner States.

Thus in Australia: August 22 1990 *Thiel* (Article 7) Franklyn J. (88 ATC 4,111 and 4,112), Lee J. (89 ATC 4,047 and 4,048), Northrop J. (89 ATC 4,024) and Sheppard J. all contrasted the 1980 Switzerland tax treaty with the 1977 OECD Model.

Sheppard J. commented (89 ATC 4,035): “1. The omission from the Swiss Agreement of a provision to the effect of Art. 21 of the OECD model convention ... is significant because it tends to establish that the parties did intend there to be areas of income earning to which the agreement would not apply with the consequence of

double taxation in some circumstances.

2. That significance is heightened by a reservation made by Australia when entering into the agreement [the 1977 OECD Model] that it reserved its position on Art. 21 and would wish to maintain the right to tax income arising from sources in Australia ...”

Unfortunately, these Judges’ commendable research was to little avail – because they all (with the exception of Northrop J.) ignored the international tax treaty context of the terms in issue (see Chapter 8.16).

In Canada: April 26 1991 *Gu* (Article 15) counsel correctly argued (91 DTC 823) that Article 19 of the 1986 China tax treaty was broader than its 1977 OECD Model analogue – because it omitted this analogue’s proviso.

In Canada: November 8 1993 *Crown Forest* (Article 4) Heald J. contrasted (94 DTC 6113) Article IV.1 of the 1980 US tax treaty with Article 4(1) of the OECD 1977 Model. He noted that (the former) Article IV.1 did not include (the latter) Article 4(1)’s second sentence: “But this term [resident of a Contracting State] does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.” He commented (94 DTC 6113): “Absent evidence of a contrary intent, I think it reasonable to conclude, firstly, that the drafters of this Convention were well aware of the O.E.C.D. clause and, secondly, that its omission from this Convention was intentional.” Heald J. then concluded (arguably, erroneously – see the *Editorial* on this decision in *The International Tax Treaties Service*): “The omission of this clause indicates that it was not the intention of the drafters to make liability to tax on a world-wide basis a necessary condition for resident status under the Convention.”

23.18 *The history of tax treaty terms may be significant*

The history of tax treaty terms can be illuminating – as can their evolution (see Chapter 26.01).

For example, Germany: *July 31 1991 BFH/1* (Article 19) involved an amendment (by a 1965 Protocol) to Article XI of the 1954 US tax treaty. The amendment sought to ensure that the treaty conformed more closely to the 1963 OECD Draft.

In view of this, *July 31 1991 BFH/1* held that Article XI (as amended in 1965) should have the same meaning as its 1963 OECD Draft analogue. It held that Article XI (as amended) therefore only applied to compensation paid by a State in respect of “the discharge of functions of a governmental nature” – words which only appeared in the 1963 OECD Draft and not in Article XI (as amended). Accordingly, Article XI did not apply when a State paid funds on behalf of a non-State entity, as its agent.

Switzerland: *June 22 1990 Bundesgericht/2* (Article 4 and see Chapter 9.01) involved the wording of the “anti-abuse” Article 23(1)(c) of the 1971 Germany tax treaty. The Bundesgericht held that because this wording’s meaning was unclear, the understanding of both Contracting States at the time they concluded the tax treaty had to be considered. The Swiss tax authorities had proved that they and the German tax authorities had negotiated Article 23(1)(c) so as to model it on the Swiss December 14

1962 Federal Decree as amplified by the December 31 1962 Federal Letter (both Article 4). The Bundesgericht held that these provisions sought to preclude any treaty abuse – and did not seek to permit some treaty abuse, providing aggregate rules were observed. The tax treaty was to be interpreted on similar lines.

23.19 *The tax treaty background in each State; a predecessor tax treaty*

Only tax treaties which exist at the time a tax treaty is negotiated could ever have been in the minds of its negotiators. The tax treaty which will often be foremost in the minds of these negotiators will be a predecessor tax treaty – clearly part of a successor tax treaty's background.

Thus, in UK: June 12 1986 *Sun Life* (Article 7) Fox L.J. noted in the Court of Appeal (59 T.C. 330): “ ... the problem has to be considered against the historic background to the Treaty and also the other provisions of the Treaty itself. As regards the historic background to the Treaty, we should refer to the following matters: (1) The parties to the 1980 Treaty were negotiating against the background of the existing treaty of 1967.”

23.20 *Existing material on a predecessor tax treaty and estoppel*

Existing interpretative material which relates to tax treaties other than the one at issue can never be conclusive as to the meaning of its terms – at least in the absence of evidence that both treaty partner States intended this to be the case. This remains true even when identical treaty terms are at issue – and even when they appear in successive treaties between the same treaty partner States.

Just as a predecessor tax treaty forms part of a successor/amending tax treaty's background, so a bilateral agreement on the interpretation of a predecessor tax treaty forms part of the successor/amending tax treaty's background. At the time they negotiate a successor tax treaty, both States will obviously be aware of any such agreements – which, at a public international level (as between these two States), may govern the meaning of identical terms in the successor tax treaty in the absence of evidence to the contrary.

At a domestic level, however, such bilateral material should only be taken into account if it is publicly available – see Chapter 21.04.

Although it is difficult to argue that a bilateral agreement on one tax treaty can apply to other tax treaties (see Chapter 23.23), taxpayers may nevertheless be able to advance an estoppel argument as regards an existing agreement involving a predecessor tax treaty. The issue of estoppel is discussed in Chapter 27.29, notably as regards contemporaneous or subsequent bilateral agreements

The weight which should be given to unilateral interpretative material on a predecessor tax treaty is discussed in Chapter 24.04.

23.21 *The tax treaty background in each State; existing third State tax treaties*

Under Article 3(2) of the 1977 and 1992 OECD Models, undefined tax treaty terms

are to be defined by reference to domestic tax law – unless the context otherwise requires (see Chapter 7.04 onwards). Avery Jones *et al.* considered (1984, 24 and 25, footnotes omitted) whether the tax law referred to by Article 3(2) “... could include treaty law since the other treaties concluded by that State would be, or become, part of its internal law. If this were correct, a definition in another treaty could be read into the treaty under discussion. But it is thought that either the reference to law should be construed as relating only to internal law, or this must be a case where the context would otherwise require.”

There are three other reasons why Article 3(2)’s reference to domestic tax law cannot involve the importation of terms in earlier tax treaties.

Firstly, why should terms in an existing tax treaty be imported into a tax treaty concluded subsequently? If it had been possible to include these terms in an earlier tax treaty, there is no reason why (had the wish to include these terms existed) they could not have been included in a subsequent tax treaty.

Secondly, even if a tax treaty is incorporated into domestic law, it will not be, in Article 3(2)’s words (italics added): “... *the law* of that State concerning the taxes to which the Convention applies”. Such taxes are defined in Article 2 of the 1977 and 1992 OECD Models as (italics added): “... the taxes on income and on capital *imposed* on behalf of a Contracting State”. Tax treaties cannot normally impose tax – so a tax treaty, with its primary purpose of *avoiding* double taxation (see Chapter 11.01) could hardly be regarded as *the law* concerning such *imposed* taxes.

Thirdly, even identical definitions appearing in tax treaties negotiated between State A and States B, C and D cannot be imported into a bilateral tax treaty between State A and State E. To do this would impose terms on State E (and, possibly, State A) which one (or both) of these States had not agreed to. As Chapter 5 illustrates, bilateral tax treaties must be interpreted in accordance with the understanding of both treaty partner States – not one State nor, worse still, neither State.

For this third reason, in Canada: November 8 1993 *Crown Forest* (Article 4) Muldoon J. in the Trial Division rejected the plaintiff’s reliance on Canada’s tax treaties with Australia, India, New Zealand, Norway and Trinidad and Tobago. Muldoon J. did not even give the dates of these treaties – one of which (with India) post-dated the 1980 US tax treaty at issue by five years – because he considered them all to be irrelevant.

He commented (91 DTC 6309) that these treaties had been invoked “to demonstrate to the Court that, if it be the purpose evinced in the treaty to determine residence outside of the treaty, then the treaties provide that very basis of determination. Such comparison is hardly relevant. Treaty-making is not performed with nearly the same unique institutional continuity, nor complete control of contents, as is legislation-making. Therefore it seems to be not particularly logical or useful to impart a meaning to the expressions articulated in one treaty between Canada and one treaty partner from the meaning of the expressions articulated in another treaty with another partner whose legal, economic and political exigencies, not to emphasize its distinct treaty-negotiating

personnel and techniques, may be quite distinct from the first. However, at base all the plaintiff really seeks to establish is the proposition that in each instance – and therefore in this instance – the treaty-makers in concluding their negotiations said what they meant, and must be held to mean what they said. The Court takes that proposition for given in regard to the Convention while paying scant heed to other treaties.”

However, in *South Africa: March 10 1992 ITC 1544* (Article 24) Melamet J. found it most instructive to compare (1992 SATC 463) the 1971 Netherlands tax treaty with earlier 1946 and 1968 UK tax treaties and with (unnamed) subsequent tax treaties – see Chapter 26.01.

In contrast, Fox L.J. in *UK: May 19 1989 Padmore* (Article 3) refused to compare different tax treaties. He held (62 T.C. 377 and see Chapter 26.01): “Reference to the provisions of other Double Taxation Arrangements are not, in my view, of assistance. We are construing this particular Arrangement. Other countries may have negotiated different bargains.”

Courts, tax authorities and taxpayers have frequently made references to other existing (and subsequent – see Chapter 26) tax treaties in support of their arguments as to the meaning of tax treaty terms. For example, only months after Fox L.J. opposed this practice in *Padmore*, *UK: December 8 1989 Vas* (Article 14) was heard.

In *Vas* the Revenue sought to interpret the 1977 Hungary tax treaty by reference to the 1975 US tax treaty – whilst the taxpayer sought to interpret it by reference to the 1945 US tax treaty. Vinelott J. considered both US treaties in coming to his “conclusion” which, he felt, was (1990 STC 147) “supported by consideration of the context and scheme of the Hungarian treaty (and of the USA treaty) as a whole”. Vinelott J.’s consideration of this material would have been improved had he also considered US rulings on these UK/US tax treaties and on other US tax treaties.

US courts have considered earlier US tax treaties in interpreting a tax treaty. For example, in *US: January 16 1963 Samann* (Article 25) Judge Bryan noted that six tax treaties earlier than the 1951 Switzerland tax treaty at issue had used the same term “permanent establishment” – which he described (313 F.2d 463) as “almost a tax treaty word of art”, and which had been elaborated upon in similar Treasury Regulations. Judge Bryan held (313 F.2d 462 and 463): “These agreements all antedate 1951 and their translation by the Treasury in this manner and to this extent has continued uninterruptedly ever since their inception. A regulation of such constancy is staunchly endowed with a presumption of validity ...” – see Chapter 28.14.

In *US: August 25 1982 Brown and Williamson* (Article 29) the majority interpreted the 1975 UK income tax treaty by reference to, inter alia, the 1945 UK estate tax treaty (which had been revoked in 1978). However, the dissenting Senior Judge Skelton argued against considering other tax treaties – see Chapter 26.03.

In *US: April 11 1983 Burghardt Estate* (Article 3), involving the 1955 Italy estate tax treaty, Tannenwald J. considered earlier estate tax treaties with Canada, France and Greece – see Chapters 10.11 and 25.09.

In *US: April 20 1994 Barquero* (Article 26) Judge Vela in the District Court

interpreted the 1989 Mexico TIEA by reference to the 1988 Bermuda TIEA – see Chapter 25.09.

23.22 Governmental material may refer to existing tax treaties

When Governmental material explaining a tax treaty refers to other existing tax treaties, they may usefully highlight similarities or differences in wording – as may later tax treaties (see Chapter 26).

For example, in Germany: *November 4 1988 Dusseldorf FG* (Article 23) the taxpayer argued that the 1959 Netherlands tax treaty should be construed as implicitly granting an income affiliation privilege – because a net worth affiliation privilege was implicitly available in all other German tax treaties. An income affiliation privilege would preclude Germany from taxing dividends distributed by a Netherlands resident company to a company resident in Germany owning at least 25% of its voting shares.

The Finanzgericht rejected this argument. It noted that no income affiliation privilege appeared in the comparable (earlier) 1954 Austria tax treaty – which was referred to in the Explanatory Memorandum to the June 16 1959 Netherlands tax treaty. However, the (earlier) 1958 Luxembourg and (later) July 21 1959 France tax treaties contained explicit net worth affiliation privileges. Therefore, the absence of any affiliation privileges in the Netherlands treaty evidenced that no such privileges had been intended. The Finanzgericht also rejected the taxpayer's argument that because the availability of affiliation privileges was implicit, it had not been considered necessary to include explicit provisions to this effect in the Netherlands treaty.

Netherlands: *November 4 1992 HR* (Article 13) had to interpret the 1966 Supplementary Convention to the 1951 Switzerland tax treaty. Because the Netherlands tax authorities' Explanatory Note on this Convention referred to the 1948 US and 1959 Germany tax treaties, *August 18 1989 Hertogenbosch GH* considered them; the Hoge Raad upheld its conclusions.

23.23 Existing bilateral agreements on third State tax treaties

Bilateral agreements (to which only one of the treaty partner States is a party) which exist at the time the treaty at issue is negotiated can raise delicate points.

It is possible that more weight should be given to such a bilateral agreement than a unilateral pronouncement – because an interpretation agreed to by more than one State may be more indicative of the true meaning of a tax treaty term than a pronouncement by one State only.

However, the principal reason for giving more weight to bilateral (as opposed to unilateral) material is that one can only be certain that a State has agreed to something if it actually *has* agreed to it. This reason cannot apply to existing bilateral material which does not involve the treaty at issue – and to which, by definition, only one treaty partner State could ever have been a party.

Furthermore, bilateral agreements are, typically, far more specific than (general) unilateral rulings; in this case they should only apply to the specific tax treaty they

concern. After all, if one State's interpretative position is as evidenced in a bilateral agreement, why did it not issue a general (unilateral) ruling to this effect – or include a provision to this effect in the later tax treaty at issue?

23.24 The importance of existing OECD and UN Commentary

OECD and UN Models have no domestic legal force (see Chapter 23.16) – and neither do their Commentaries. Thus, Para. 29 of the Introduction to the (1992) OECD Model (which is virtually identical to Para. 26 of the Introduction to the 1977 OECD Model) runs in part (*italics added*): “Although the Commentaries are not designed to be annexed in any manner to the conventions to be signed by Member countries, *which alone constitute legally binding international instruments*, they can nevertheless be of great assistance in the application and interpretation of the Conventions ...”

The Introduction to the UN 1979 Model is comparable – see below.

OECD tax treaty initiatives were originally undertaken because, as Para. 5 of the Reports on the 1977 and 1992 OECD Models by the OECD Committee on Fiscal Affairs notes: “... agreement on a common interpretation” had become “increasingly desirable”. Para. 9 of the Report on the 1977 OECD Model also notes: “... the existence of the Commentaries has facilitated the interpretation and the enforcement of bilateral conventions along common lines.”

Some may argue that even when the texts of an OECD Model and a tax treaty are identical, little weight should be given to this Model's OECD Commentary – even when it pre-dates the tax treaty at issue, and even when this treaty is between two OECD Members. They may argue that the actual text of a treaty is the only definitive source of the meaning of a term therein, and that this text is the best evidence of any intended meaning. This argument derives much of its strength from Article 31(1) of the 1977 Vienna Convention – see Chapter 6.01.

Despite the undoubted strength of this argument, it is much lessened in the case of OECD Commentary which is, as Ward observed (1980, 549): “akin to the minutes of the negotiators of a multinational treaty”. OECD Commentary is clearly meant to govern the interpretation of terms in the Model to which it relates, and of identical terms in tax treaties based on this Model. This is notably the case when Commentary pre-dates a tax treaty – because, as regards such a (later) tax treaty, each OECD Member must be presumed to be aware of the existing Commentary's interpretation of identical terms.

Furthermore, the Commentary on OECD Models represents the collective views of OECD Members. If a Member disagrees with any part of the Commentary on an OECD Model, it may make an “Observation” to this effect. Similarly, if a Member disagrees with any part of any Article in an OECD Model, it may make a “Reservation” as to its position – and include different terms in its tax treaties. Observations on the Commentary are rarer than Reservations on (part of) an Article; both appear at the end of the Commentary on each Article.

In the absence of an Observation or Reservation, each OECD Member State must be

presumed to agree with the interpretation given to any term in any OECD Model Article by its Commentary. As Messere commented (1993, 251 and see above): "... the Commentaries are an integral part of the Model".

An April 11 1977 recommendation by the OECD Council, in Appendix I to the 1977 OECD Model, confirms the importance of the OECD Commentaries in interpreting tax treaty terms. It runs in part (*italics added*): "THE COUNCIL ... 1. RECOMMENDS the Governments of Member Countries ... 2. when concluding new bilateral conventions or revising existing bilateral conventions between them, to conform to the Model Convention ... *as interpreted by the Commentaries thereto* and having regard to the reservations and derogations to the Model Convention".

On July 23 1992 the above recommendation was repealed – to be replaced by a virtually identical recommendation in relation to the 1992 OECD Model (in its Appendix II). However, this 1992 recommendation ends with the words "having regard to the reservations and observations to the Model Tax Convention ... and subject to any future amendments thereto that may be adopted by the Council." These words reflect the OECD Model's new looseleaf format – see Chapter 23.13.

The 1979 UN Model stresses the importance of its Commentary even more highly.

Section 3 of the Introduction to this 1979 UN Model runs in part (*italics added*): "If the negotiating parties decide to use in a treaty wording suggested in the UN Model Convention, it is to be presumed that they also wish to follow the interpretation of that wording given in the relevant commentary. The commentaries, which may prove very useful in the implementation of the treaty concluded by the negotiating parties and in the settlement of any dispute relating thereto, are not intended to be annexed to such a treaty, *the text of which in itself would constitute the legally binding agreement.*"

The importance of the 1977 OECD Model and *its* Commentary in interpreting the 1979 UN Model are also made clear in Section 3's subsequent paragraph which runs: "Since the UN Model Convention reproduces many articles of the OECD Model Convention together with the commentaries thereon, the reservations concerning these articles or commentaries and the observations on the commentaries may be assumed to be automatically applicable *mutatis mutandis.*" Section 3 then goes on to cite extracts from Paras. 27 and 29 (involving reservations and observations) of the Report of the OECD Committee on Fiscal Affairs on the 1977 OECD Model.

Very occasionally, tax treaties themselves refer to OECD material. For example, Ad Article 3(2) of the June 18 1971 Protocol to the August 11 1971 Germany/Switzerland tax treaty runs: "The competent authorities of the two Contracting States shall take into consideration for the interpretation of the provisions of the Convention as provided for in Article 26 [Mutual Agreement Procedure] of the Convention, the interpretation which has been developed within the Organization for Economic Cooperation and Development (OECD) with respect to the Model Convention for the avoidance of double taxation of income and capital, of July 30 1963."

Similarly, to compensate for the fact that Article 4 of the 1971 Japan/Switzerland tax treaty does not contain the residence "tie-breaker" provisions in Article 4(2) of the

1963 OECD Draft, Para. 2 of a contemporaneous exchange of notes runs: “2. With reference to paragraph 2 of Article 4 of the Convention, it is agreed that the determination by mutual agreement of the status of an individual who is a resident of both Contracting States shall take into consideration the rules as set out in paragraph 2 of Article 4 of the [1963] Draft Double Taxation Convention on Income and Capital of the Organisation for Economic Cooperation and Development.”

It is clear from the above that OECD Commentary on an OECD Model should be accorded great weight. This is in line with the 1992 ALI Report’s recommendation (52 and 53) that “substantial weight” should ordinarily be given to the OECD Model and its Commentary. This Report comments (54) that these OECD materials “occupy a unique position in the hierarchy of international tax materials. In practice both administrators and tax advisors automatically consult these materials when attempting to understand the meaning of treaty provisions. It would be wholly unrealistic, at least in the absence of strong evidence to the contrary, to think that treaty negotiators who adopted language derived from the OECD text were not familiar [*sic*] with and therefore did not knowingly accept the common meaning of that language as agreed among the OECD member countries.”

This comment undoubtedly applies to tax treaties negotiated between OECD Members. It probably applies to tax treaties modelled on OECD lines between a State which is not an OECD Member and a State which is an OECD Member. It may also apply to tax treaties modelled on OECD lines between two States which are not OECD Members.

To resolve uncertainty, the US and Korea have reportedly signed a 1993 Memorandum of Understanding pursuant to which Korea has agreed to apply OECD principles in interpreting the 1976 Korea/US tax treaty.

However, the ALI Report does not focus on one factor which militates against OECD Commentary being accorded as much weight at a domestic level as at a public international level. This factor is that this Commentary may reflect what the OECD (or its Committee on Fiscal Affairs) *wants* a tax treaty term to mean, and not what a tax treaty term *does* mean. This factor is particularly relevant as regards Commentary which post-dates a tax treaty – so it is discussed in Chapter 26.04 onwards.

23.25 Domestic courts have often referred to existing OECD Commentary

At a public international level, existing OECD Commentary must normally be conclusive, at least as between OECD Members, as regards the meaning of tax treaty terms in respect of which an OECD Member has not made an Observation or Reservation. This is because OECD Members negotiating tax treaties after such Commentary has been published must be presumed to have approved of it – explicitly or implicitly.

At a domestic level, existing OECD Commentary cannot be conclusive – even as between OECD Members – because it is not part of the text or context of a tax treaty (see Chapter 23.24). Nevertheless, it should be accorded considerable weight – as

already happens. Domestic courts in Australia, Canada, Germany, the Netherlands, New Zealand, South Africa, Switzerland, the UK and the US have increasingly held that earlier OECD Commentaries may be used as a means of interpreting later tax treaties.

However, these materials do not always get the detailed and informed attention that they deserve. For example, in Australia: August 22 1990 *Thiel* (Article 7) the Western Australian Supreme Court, the Federal Court (all three Judges) and the Full High Court (all five Judges) all approved of the 1977 OECD Model and its Commentary being used to interpret the (later) 1980 Switzerland tax treaty. However, most of the Lower Court judgments are flawed – because they did not consider these materials sufficiently deeply, and focused excessively on domestic law (see Chapter 8.16).

In the Full Federal Court, Sheppard J. cited the Vienna Convention as justifying his reference to the 1977 OECD Model and its Commentary. However, he misunderstood the nature of this OECD material when he commented (89 ATC 4,034): “If there be the need to resolve an ambiguity, the Court is entitled to look at the OECD model convention, the OECD commentary thereon and any reservations noted when Australia acceded to the convention. These are not *travaux préparatoires* because they are not working papers leading up to the adoption of the convention. Rather they are documents which have been agreed to, subject to the observations and reservations that have been noted by countries when acceding to the convention. Thus they ought to be accorded as much if not more weight than *travaux préparatoires*. That the model convention and the commentary thereon are documents which the Court is entitled to consider is established by *Sun Life Assurance Co. of Canada v. Pearson* [UK: June 16 1986 *Sun Life* – Article 7 and see below] (1986) S.T.C. 335 at pp. 345-347.”

Sheppard J.’s initial reference to “ambiguity” implies that he assumed that Article 32 of the Vienna Convention enabled him to consider this OECD material. This is a correct assumption, as indicated in Chapter 19.01. However, it is inaccurate to describe an OECD Model as a “convention” to which Australia (or any other State) has acceded to. As indicated above, an OECD Model is just that – a model which States can agree on, not a convention nor a treaty which, if it is to have legal force, States must accede to.

In the Full High Court, McHugh J. (with whom Mason C.J., Brennan J. and Gaudron J. agreed) also cited Articles 31 and 32 of the Vienna Convention and commented (90 ATC 4,727): “The Agreement is one “for the avoidance of double taxation with respect to taxes on income”. Accordingly, it is necessary to interpret the words of the Agreement with that particular purpose in mind. Moreover, the term “enterprise” in Art. 3 and 7 of the Agreement is ambiguous because, on the one hand, it can mean a project or activity undertaken and, on the other hand, it can mean a framework for making and carrying out decisions in respect of activities and projects. Consequently, it is proper to have regard to any “supplementary means of interpretation” in interpreting the Agreement. In this case, the “supplementary means of interpretation” are the 1977 OECD Model Convention for the Avoidance of Double Taxation with respect to Taxes

on Income and on Capital, which was the model for the Agreement, and a commentary issued by the OECD in relation to that model convention.”

Dawson J., the fifth Judge in the Full High Court, held (90 ATC 4,722 and 4,723): “In at least one case (*Sun Life Assurance Co. of Canada v. Pearson* [UK: June 16 1986 *Sun Life* – Article 7 and see below], (1986) 59 T.C. 250 at p. 331), the model convention and commentaries have been used in the construction of a double taxation agreement. This is, I think, permissible under the Vienna Convention on the Law of Treaties. Switzerland is not a party to the Vienna Convention (although Australia is) but the relevant rules which it lays down are applicable, being no more than an indorsement or confirmation of existing practice: ... [and Dawson J. cited *Fothergill* – see Chapter 3.13] Moreover, as Lord Radcliffe observed in *Ostime v. Australian Mutual Provident Society* [UK: July 16 1959 *Ostime* – Article 7 and see Chapter 26.15] (1960) A.C. 459 at p. 480, an expression such as the word “enterprise” may have no exact counterpart in domestic tax laws, being part of an “international tax language”.”

Dawson J. then referred to Article 31 of the Vienna Convention, continuing (90 ATC 4,723): “Article 31 of the Vienna Convention provides that a treaty is to be interpreted “in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose”. The context includes, in addition to the text, any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty. For my part, I do not see why the OECD model convention and commentaries should not be regarded as having been made in connection with and accepted by the parties to a bilateral treaty subsequently concluded in accordance with the framework of the model. However, some doubts have been expressed about the applicability, as a matter of language, of Art. 31 to the commentaries in the case of a bilateral treaty such as a double taxation agreement: see Jones et al., ...[Avery Jones *et al.* 1984, 92].”

Rightly apprehensive about disagreeing with such collective wisdom, Dawson J. continued (90 ATC 4,723): “I turn, therefore, to Art. 32 of the Vienna Convention which allows recourse to be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Art. 31, or to determine the meaning when the interpretation according to Art. 31 leaves the meaning ambiguous or obscure or leads to a result which is manifestly absurd or unreasonable. Whilst the model convention and commentaries may not strictly amount to work preparatory to the double taxation agreement between Australia and Switzerland, they are documents which form the basis for the conclusion of bilateral double taxation agreements of the kind in question and, as with treaties *in pari materia*, provide a guide to the current usage of terms by the parties. They are, therefore, a supplementary means of interpretation to which recourse may be had under Art. 32 of the Vienna Convention.”

In Canada: October 23 1991 *Hinkley* (Article 15) Lamarre Proulx T.C.J., citing (91 DTC 1338) UK: June 12 1986 *Sun Life* (Article 7 and see below) which itself cited

Fothergill (see Chapter 3.13 and below), held that 1977 OECD Commentary could be used to interpret the 1980 US tax treaty and referred to it in detail.

Germany: *January 23 1985 BFH* (Article 5) involved some tax treaties which post-dated the 1963 OECD Draft. It referred to Para. 11 of the Commentary on Article 5 of the 1963 OECD Draft (which is virtually identical to Para. 21 of the Commentary on Article 5 of the 1977 OECD Model). In line with this material, it held that the processing of information, unlike the mere collection of information, was not of a preparatory or auxiliary character.

Germany: *July 4 1991 Lower Saxony FG/1* (Article 5) referred to the Commentary on Article 5(4) of an (unspecified) OECD Model.

Germany: *February 26 1992 BFH* (Article 7) referred to the 1963 OECD Draft in interpreting the 1971 Switzerland tax treaty. It held that no reduced rates of tax could apply to dividends “attributable to” a German permanent establishment – and that the words “attributable to” were analogous to the words “effectively connected with” in Article 10(4) of this 1963 OECD Draft.

Japan: *June 11 1982 Tokyo District Court* referred to an OECD Model and Commentary (see Nakazato 1993, 413, Footnote 25).

Netherlands: *October 11 1978 HR* (Article 11) held that because Para. 20 of the Commentary on Article 11 of the 1963 OECD Draft (repeated virtually verbatim in Para. 9 of the 1977 OECD Commentary) permitted the source State to levy income tax on interest, such tax could be levied under the 1970 Belgium tax treaty.

Netherlands: *November 23 1983 HR* (Article 17) considered the 1977 OECD Commentary in relation to the 1980 UK tax treaty.

Netherlands: *September 2 1992 HR* (Article 10) found the 1963 OECD Commentary most helpful in interpreting the 1969 Ireland tax treaty and in reversing *January 30 1990 The Hague GH* – see Chapters 25.02 and 26.01.

In New Zealand: *July 16 1973 UDT* (Article 24), involving the 1966 UK tax treaty, the 1963 OECD Draft was produced by consent. The President (McCarthy P.) commented (1 NZTC 61,030) that the 1966 UK tax treaty was based on the text of a 1963 Convention recommended by the OECD “which, in addition to proffering a draft Convention which uses international tax language, issued, as is its practice in such circumstances, a Commentary on the text. The Agreement does not slavishly follow the Convention. There are departures of some materiality. It was urged ... that we were entitled to examine the [1963 OECD Draft] Convention and the Commentary as an aid to interpretation (*Salomon v. Commissioners of Customs and Excise* (1967) 2 Q. B. 116) but I have not found it necessary to do so.”

New Zealand: *June 14 1990 JFP Energy* (Article 15) involved the 1982 US tax treaty. Richardson J. (also delivering the judgment of Hardie Boys J.) considered (12 NZTC 7,178) the Commentary on the 1977 OECD Model “on which New Zealand’s recent double taxation treaties including the relevant US agreement are based ...”

In New Zealand: *October 2 1992 Squibb* (Article 25), involving the 1972 Australia tax treaty, Richardson J. considered (14 NZTC 9,155) Commentary on the 1963 OECD

Draft.

In South Africa: August 19 1975 *Downing* (Article 5), notably in the Special Court, the tax authorities cited the Commentary on Article 5 of the 1963 OECD Draft. They argued unsuccessfully that, under the 1967 Switzerland tax treaty, a stockbroker acting with complete autonomy was a permanent establishment of his client.

Switzerland: *September 17 1977 Bundesgericht* (Article 5) noted the declaration by the Federal Council that the 1966 Spain tax treaty was based on the 1963 OECD Draft. It held: "One must therefore interpret the provisions of this Convention in the light of the Commentaries which the OECD fiscal Committee gave in a July 1963 Report." It then cited Para. 13 of the Commentary on Article 5 of the 1963 OECD Draft.

In UK: June 12 1986 *Sun Life* (Article 7) the parties, the Special Commissioners, the High Court, and Court of Appeal, all accepted that 1977 OECD Commentary could be used to interpret the 1980 Canada tax treaty.

In the High Court Vinelott J. commented (*italics added*) (59 T.C. 310): "It is common ground that in the light of the decision of the House of Lords in *Fothergill v. Monarch Airlines Ltd.* [1981] AC 251 [see Chapter 3.13] *the Commentaries can and indeed must be referred to as a guide to the interpretation of the Treaty.*"

Delivering the judgment of the Court of Appeal, Fox L.J. commented similarly (59 T.C. 331): "... it is common ground that we are entitled to consider the Commentary in determining the construction of the Treaty (see *Fothergill v. Monarch Airlines Ltd.* [1981] AC 251 at page 280)." Unfortunately, Fox L.J. described this Commentary as being on the 1963 OECD Draft – whereas it was on the 1977 OECD Model.

As indicated above, Fox L.J.'s reliance on OECD Commentary was approved in Australia: August 22 1990 *Thiel* (Article 7 – by Sheppard J. at 89 ATC 4,034 and by Dawson J. at 90 ATC 4,722) and in Canada: October 23 1991 *Hinkley* (Article 15 – by Lamarre Proulx T.C.J. at 1991 DTC 1338).

UK: December 8 1989 *Vas* (Article 14) involved the November 28 1977 Hungary tax treaty. Vinelott J. (again) noted (1990 STC 147g) that UK courts could refer to "... the EEC [*sic*; presumably 1977 OECD] model convention which is accompanied by a commentary explaining the principles on which it is based."

23.26 Tax authorities have often referred to existing OECD Commentary

Canada: January 30 1989 IT-173R2 (Article 13) gives examples of a "fixed base" – a term not defined in the 1980 US tax treaty. Some of these examples mirror those in Para. 4 of the Commentary on Article 14 of the 1977 OECD Model – but, curiously, IT-173R2 does not acknowledge this obvious provenance.

US: Rev. Rul. 75-131 (Article 14) also involves the meaning of fixed base – a term not defined in the 1967 France tax treaty. The report of the Senate Foreign Relations Committee on this treaty noted that the "fixed base" concept was not found in other US tax treaties but was derived from the 1963 OECD Draft. Accordingly, Rev. Rul. 75-131 refers to the 1963 OECD Commentary as an aid to interpretation.

US: LR 80-30-005 (Article 24) and Rev. Rul. 81-132 (Article 10) both involve the

1965 Supplementary Convention to the 1948 Netherlands tax treaty. LR 80-30-005 notes that the State Department Report on the Supplementary Convention indicated that one of this Convention's purposes was "to reflect certain principles expressed" in the 1963 OECD Draft. Rev. Rul. 81-132 notes, similarly, that this Convention's changes "were made in part to conform Article VII more closely to Article 10 of the" 1963 OECD Draft.

LR 81-31-059 (Article 10) involves the 1971 Finland tax treaty. The Treasury Department Technical Explanation explains that Article 12 of this treaty "is patterned generally" after the 1963 OECD Draft. LR 81-31-059 therefore considers this 1963 OECD Draft in interpreting the term "dividend".

US: Rev. Rul. 86-145 (Article 15) notes that the Treasury Department Technical Explanation of the 1980 UK treaty explains that its Article 15 is based on Article 15 of the 1977 OECD Model, and considers its OECD Commentary.

LR 87-48-003 (Article 15) involves the 1965 Protocol to the 1955 Germany tax treaty. It rejects an argument by the taxpayer based on analogous provisions in the 1963 OECD Draft – but impliedly accepts that this Draft could be relevant.

Chapter 24 Domestic circumstances of a tax treaty's conclusion

24.01 *Each State's domestic fiscal circumstances*

A tax treaty will have been drafted against a background which will, inevitably, include each treaty partner State's domestic laws – see Chapter 8.08.

Accordingly, each State must be presumed to be aware of the main features of a treaty partner State's tax laws and of the terms used in its fiscal legislation. These may explain why particular tax treaty terms are used, and what they mean.

In Canada: January 28 1985 *Gladden Estate* (Article 13 and see Chapter 9.16) one issue was whether an exemption from capital gains tax under the 1942 US tax treaty covered a deemed disposition on death – even though this treaty exemption was only expressed as covering a sale or exchange (see Chapter 12.06).

Addy J., focusing on Article 32 of the Vienna Convention, found that the absence of capital gains tax legislation in Canada in 1942, and the treaty's use of the terms "sale or exchange" (which mirrored terms used in US domestic legislation), formed part of "the circumstances of [the] conclusion" of this treaty.

Addy J. commented (85 DTC 5192): "As to the surrounding circumstances when the treaty was signed, Canada had no capital gains tax legislation and the US legislation at the time used the terms "sale or exchange". This accounts for the reason why those very words were used in the treaty. There seems to be little doubt, however, that the general intention was to exempt non-residents of each of the contracting countries from capital gains taxes generally. With regard to paragraph (b) of Article 32 of the Vienna Convention, supra, regarding the avoidance of a result which might be manifestly *unreasonable* or *absurd*, to hold that a deemed disposition would, as claimed by the Minister, be taxable as a capital gain while a true sale or exchange would not, would be both unreasonable and absurd. Real commercial transactions would be taxable while artificially created ones would not. In the case at bar, for instance, it is abundantly clear that had the deceased disposed of the shares immediately before his death in consideration of payment of the full market value thereof, his estate would not have been taxable in any way on a capital gain. Yet, because he died and there is deemed to be a disposition of the shares, the result would be that his estate would be taxable although no real "sale or exchange" or other disposition actually took place."

In UK: February 9 1990 *Commerzbank* (Article 7 and see Chapter 3.14) Mummery J. refused to attach weight to US tax law at the time of the 1945 US tax treaty – but his refusal should be considered in the light of the fact that he (correctly) distinguished the approach in US: May 5 1982 *Great-West* (see Chapter 6.05) and (equally correctly) disregarded a UK/US competent authority agreement (see Chapter 27.17).

24.02 *Unusual domestic fiscal circumstances*

Perhaps the most interesting argument in Canada: June 5 1992 *Hale* (Article 15 – criticised in Chapter 8.17) was a secondary contention by the Crown involving s.7 of the Income Tax Act. s.7, which existed at the time of the 1978 UK tax treaty at issue

and which had not been amended since, created a presumption that a benefit from a disposal of rights under a stock option agreement “shall be deemed to have been received by the employee by virtue of his employment in the taxation year in which he made the disposition”. The Crown contended that s.7 deemed an employment to be exercised in Canada in a year when it was not in fact exercised in Canada, and thus enabled Canada to tax profits made by a UK resident disposing of stock option rights – even though the 1978 UK tax treaty contained a provision comparable to Article 15 of the 1977 OECD Model. The Crown contended (90 DTC 6484): “since the Convention was concluded after the *Income Tax Act* came into effect and the legislature did not amend the wording relating to the presumption created by s. 7 of the Act, it follows that the parties to the Convention were completely aware of the applicable law when they signed the Convention and it came into effect.” Accordingly, s.7 of the Income Tax Act should prevail over the tax treaty.

This secondary contention did not have to be decided – because the Crown’s primary contention was erroneously upheld (see Chapter 8.17); however, it was probably inspired by Canada: January 25 1983 *Gadsden* (Article 13) – see Chapter 24.03.

24.03 *The impact of a change in domestic fiscal circumstances*

If a successor treaty is negotiated after a radical change in a State’s tax laws, the treaty partner State must be presumed to be aware of this change. Although such a change in domestic law may not override an existing tax treaty (see Chapter 10), it may determine the meaning of an identical term in its *successor*. This is because one State’s changed legislation, which the treaty partner State must be presumed to be aware of, will form part of the background of a successor tax treaty.

In Canada: January 25 1983 *Gadsden* (Article 13 and see Chapters 8.17 and 9.04) a UK resident appellant disposed of a life interest in a Canadian trust in 1976. Prior to 1972 such a disposition would have resulted in a (non-taxable) capital gain. However, a 1972 change in Canadian domestic legislation, introducing s.106(2)(b) of the Income Tax Act, made this disposition liable to Canadian income tax.

The Tax Review Board held that Article 12(3) of the 1966 UK tax treaty, which was in force when the 1972 legislation was enacted, protected the appellant against this new (1972) charge to tax. Did the 1980 tax treaty similarly protect the appellant?

The Board rejected the appellant’s argument (83 DTC 135) that the Canadian Parliament had tried “to unilaterally restrict the application of the 1980 Convention with respect to a UK resident by altering the true legal fiscal nature of an income life interest in a trust”. This argument was based upon Canada: March 12 1980 *Associates* (Chapter 9.13) and September 28 1982 *Melford* (Chapter 10.08) (both Article 7).

Mr. Tremblay held (83 DTC 135 and 136): “... it is impossible to contend that Canadian Parliament attempted to restrict the application of the 1980 Convention, since the said Convention was not in force when paragraph 106(2)(b) was adopted. The Board shares the opinion of the respondent’s counsel that:

If the UK Government having full knowledge of the Canadian domestic tax laws at

the time it signed the Convention did not see fit to negotiate with the Canadian Government for the inclusion in the convention of a provision to cover such cases, then one must conclude that the UK Government was satisfied with the situation.”

24.04 Existing unilateral material on the predecessor tax treaty

A bilateral agreement on the meaning of a term in a predecessor tax treaty may not be conclusive as regards the meaning of an identical term in its successor – see Chapter 23.20; unilateral material may be even less conclusive.

In France: *March 14 1979 CE* (Article 4, criticised in Chapter 28.08) Commissaire Rivière noted that some terms in the 1966 Switzerland tax treaty are very similar to those in its 1953 predecessor. This 1953 wording had been the subject of January 26 1974 Reply Bourgeois (Article 4) – which purported to explain the mutual understanding of both States as to the meaning of this wording. The French tax authorities argued that this Reply should also apply to the successor 1966 treaty.

Commissaire Rivière disagreed with this argument – on principle. He concluded: “... if it is true that the interpretation given to a treaty, on the occasion of a specific matter, is binding in respect of all subsequent matters, it is not true that it is equally binding in respect of another treaty, even when this treaty is concluded between the same States and contains the same wording. The “wish of the negotiators” could have changed.”

Nevertheless, at the time a successor tax treaty is negotiated, a unilateral ruling on a predecessor treaty will undoubtedly be taken into account by the State which issued it – because tax authorities typically interpret tax treaty terms consistently (see Chapter 24.07). Accordingly, it is arguable that the inclusion in a successor tax treaty of a term in a predecessor tax treaty which has already been “interpreted” by a unilateral ruling issued by one State both confirms this interpretation in this State, and should be presumed to have been agreed to by the treaty partner State.

24.05 Each State's existing material on third State tax treaties

Obviously, less weight should be given to material which does not involve the tax treaty at issue (or a predecessor tax treaty) than material which does. This is because of the difficulty of showing that the former material was taken into account by both States when they negotiated the tax treaty in issue.

Prior to the publication of *The International Tax Treaties Service*, it was virtually impossible for a State (or anyone else) to become aware of more than a few significant tax treaty decisions or rulings in a treaty partner State – or, indeed, in any other State. *The International Tax Treaties Service* has, however, largely removed this difficulty. Such interpretative positions can now form part of the background to a tax treaty – even if this material relates to third State tax treaties. In the absence of any indication to the contrary, treaty partner States must be presumed to be aware of this material.

Tax authorities typically interpret tax treaty terms consistently – see Chapter 24.07. Accordingly, it is arguable that one State's existing material on third State tax treaties will normally evidence its known interpretative position at the time a tax treaty is

negotiated. This argument that, in the absence of any indication to the contrary, a State has concurred with a known interpretative position in its treaty partner State at the time a treaty is negotiated is likely to be made in the future. Comparable arguments have already been advanced – and upheld – in relation to changes in domestic law (see Chapter 24.03) and unilateral legislative history (see Chapter 25.10).

Existing material on third State tax treaties will typically consist of jurisprudence and unilateral rulings, as well as bilateral competent authority agreements (see Chapter 23.20). This material may have to be given different weight. For example, as a general rule, the more consistent and less susceptible to change an interpretative position in one State is, the greater the weight which should be given to it.

As regards jurisprudence, courts typically interpret tax treaty terms consistently. The demands of logic, and the doctrine of precedent, will typically result in State A's courts applying their existing interpretation of a term in a State A/State B tax treaty to the same term in subsequent (and possibly prior) tax treaties concluded by State A.

However, courts should also consider existing (foreign) jurisprudence in a treaty partner State – because this jurisprudence (see Chapter 29) will indicate this State's understanding of the meaning of a tax treaty term. A bilateral tax treaty should be interpreted in accordance with the understanding of both treaty partner States – see Chapter 5.

The weight to be given to jurisprudence will depend, *inter alia*, upon the likelihood of change. A final decision by the highest court in the land should be given more weight than a decision by a lower court which can still be overruled. (However, the possibility of (final) judicial decisions being overruled by legislation should not be overlooked. Such legislation would clearly form part of the domestic background to a tax treaty.)

For these reasons, *jurisprudence* should normally be given more weight than rulings – because rulings may be overruled by judicial decisions, or simply revoked by those issuing them (see Chapters 28.03 and 28.18).

As regards unilateral rulings, the 1992 ALI Report recommends (55): “7. Other materials which may be given weight in appropriate cases include: ... (c) The unilateral practice of the government agencies charged with the negotiation and enforcement of the treaty; ...”

It is unclear whether this Recommendation refers only to the unilateral practice of the government agencies in the State in which a tax treaty dispute arises, or whether it refers also to the unilateral practice of agencies in the treaty partner State. Because a tax treaty should be interpreted in accordance with *both* States' understanding (see Chapter 5), the latter view is more appropriate. On this basis, a court in one State should also give weight to existing rulings in the treaty partner State.

It is interesting to speculate on the effect, in State A, of a decision in its treaty partner State B overruling one of State B's own domestic rulings – especially if State A *had* indicated that it agreed with this interpretation, say, prior to entering into a successor tax treaty. Were this to happen, would State A's courts also hold that the ruling was

inconsistent with the ordinary meaning of this treaty term? Or would they hold that the overruled meaning was the agreed meaning? Comparable questions arise if State B revokes a ruling which State A had indicated it agreed with.

24.06 *Third State material can be useful, especially if it involves a treaty partner State*

Jurisprudence and rulings in third States can be of global interest. Third State jurisprudence has long been cited (see Chapter 29.04) – and third State rulings are now beginning to be cited.

New Zealand: June 14 1990 *JFP Energy* (Article 15) involved the 1982 US tax treaty. JFP Energy's Counsel, using *The International Tax Treaties Service*, cited foreign material in its Article 15, including Germany: April 21 1981 Federal Ruling (which applies generally) and a US Technical Explanation referred to in US: LR 87-48-003 (which involves the 1954 Germany/US tax treaty).

Lord Chief Justice Eichelbaum noted that this material was consistent with his views (and with JFP Energy's successful arguments). However, he commented (11 NZTC 6,286): "... I take the view that even on the broader approach to interpretation permissible in relation to treaties, this material is too exiguous to be taken into account."

On (the New Zealand Revenue's unsuccessful) appeal Richardson J. described this foreign material as (12 NZTC 7,181) "too insubstantial to be taken into account" – but then relied upon, arguably, even less substantial material: unilateral material generated during the treaty's US legislative history (see Chapter 25.13).

24.07 *Tax authorities typically interpret tax treaty terms consistently*

Tax authorities typically interpret tax treaty terms consistently. As Brockway (at that time the Chief of Staff, US Congress Joint Committee on Taxation) commented (1983, 631 and 632, footnote 36 omitted): "The Treasury Department tends to view each tax treaty as a separate agreement the terms of which are to be interpreted independently, primarily with reference to the bilateral negotiations between the parties and only secondarily with reference to their interpretation in other US tax treaties. Indeed, from time to time situations arise, whether through inadvertence or not, where the parties intend a term to have a certain meaning that is inconsistent with its meaning in other treaties. This is particularly true where translation is necessary or where a specific interpretation has been agreed upon under the mutual agreement procedures. Nevertheless, the Internal Revenue Service tends to take the view (a view I strongly share) that bilateral tax treaties are part of an integrated body of law and that, absent extraordinary circumstances, the same or substantially similar language in the various US tax treaties should be given the same meaning. Obviously, from the Treasury's vantage point it would be convenient to be able to resolve interpretive [*sic*] questions arising under treaties with their foreign counterparts on a mutually agreeable basis when and if they choose to do so. It would, however, be extremely difficult for any other interested party to look at the public record and have any confidence as to the law

in the area if a de novo interpretation of the same terminology is necessary for each US tax treaty.”

US and other tax authorities have often held that they will interpret similar language in different tax treaties consistently. Accordingly, when tax authorities issue a general ruling on how they will interpret a particular tax treaty term, it must be assumed (in the absence of any indication to the contrary) that they will interpret this same term consistently in all tax treaties. Indeed, they may be bound to do so.

US: Rev. Rul. 77-45 (Article 5) is one such general ruling. It holds (*italics added*): “It is the view of the Internal Revenue Service that, in the absence of specific treaty language to the contrary, a construction site of any significant duration is *generally* considered to constitute a permanent establishment even if a treaty’s permanent establishment article is silent as to such site. It is also the view of the Service that planning and supervision carried on by a building contractor are part of the activity allocable to its construction site permanent establishment. Planning and supervision of construction work do not of themselves, however, make a construction site a construction site of the enterprise that plans and supervises construction.”

It is clear that Rev. Rul. 77-45’s general holdings are of general application.

The extent to which tax authorities interpret tax treaty terms consistently may not be generally appreciated – so some examples are now given.

Australia: January 2 1992 IT 2665 (Article 19) involves the tax treatment of Swedish Government pensions. It holds that this treatment “is broadly analogous to that applicable in respect of certain government pensions paid from Denmark, Finland, the Netherlands or Malaysia to residents of Australia.”

Austria: November 8 1990 Ruling (Article 24) holds that its principles apply to numerous tax treaties.

The French tax authorities’ November 21 1985 Instruction, acquiescing to France: *January 17 1985 Paris TGI* (Article 2), provides that it applies not only to the 1959 Austria tax treaty, but also to 21 other comparable tax treaties (see Chapter 19.10). (This Instruction was then partly overruled by France: *March 24 1992 CC* (Article 2) – see Chapter 28.07.)

Article 990 D CGI imposes a 3% annual tax on foreign entities, more than 50% of the French assets of which consist of French real estate. However, an exemption applies to a foreign entity resident in a State which has a tax treaty with France which provides for administrative assistance (full exchange of information) – but only if this entity files an annual declaration indicating its shareholders and their shareholdings.

France: *December 21 1990 CC* (Article 24) holds that the non-discrimination Article in the 1966 Switzerland tax treaty precludes the imposition of this 3% tax. France: November 29 1991 Reply Charie (Article 24) holds that, because the 1968 UK tax treaty contains a similar Article, a company resident in the UK is similarly exempted from 3% tax – whether or not it files the annual declaration. This holding implicitly applies to all (tax) treaties containing such a non-discrimination Article.

Netherlands: November 2 1987 Ruling, acquiescing to Netherlands: *May 13 1987 HR*

and *May 20 1987 HR* (all Article 18), holds that it applies not only to the 1970 Finland and 1969 Ireland tax treaties at issue, but also to 21 comparable tax treaties – see Chapter 26.01.

Netherlands: April 23 1991 Ruling (Article 23) acquiesces to three Hoge Raad decisions involving three different tax treaties – and similarly holds that their identical rationales apply to 26 comparable tax treaties.

24.08 US Rulings are often of general application

The following material, all analysed in Article 10, illustrates how a US Ruling, originally issued in relation to one specific tax treaty, has subsequently been applied generally. US Rev. Rul. 79-65 establishes the principles to be applied in determining whether a relationship was arranged or is maintained primarily with the intention of securing treaty-reduced rates of tax. It involves the 1948 Netherlands Antilles tax treaty – in relation to which it was cited in LR 81-21-084, LR 81-25-026, LR 84-52-148, LR 87-02-008 and LR 87-31-036. However, as one of the leading US Revenue Rulings on treaty-shopping, its principles have also been applied to many other (earlier) tax treaties, such as all or unnamed tax treaties (LR 81-10-024 and LR 92-05-005), the 1945 Barbados tax treaty (LR 81-08-107), the 1948 Denmark tax treaty (LR 88-02-084), the 1949 Ireland tax treaty (LR 93-09-011) and the 1951 Switzerland tax treaty (LR 84-38-077, LR 85-39-014, LR 87-47-028, LR 88-45-032, LR 93-06-019 and LR 93-33-030).

Furthermore, US Revenue or Letter Rulings interpreting one tax treaty often specifically hold that their conclusions apply to other (named) tax treaties with similar wording – and often (also) rely upon US governmental material interpreting other tax treaties.

For example, Rev. Rul. 56-164 (Article 14) interprets the 1948 Netherlands tax treaty by reference both to its Senate Executive Report (which commented that it “is designed to accomplish essentially the same objectives as income tax conventions now in force with Sweden, France, Canada and the UK”) and to a Treasury Technical Memorandum on the 1945 UK tax treaty. Rev. Rul. 56-164 concludes: “The principles herein set forth with respect to the US-Netherlands income tax convention will also apply to other income tax conventions which contain language similar to that here considered.”

Other US material which specifically applies to tax treaties in addition to the one at issue, or to all tax treaties containing similar wording, and which therefore evidences a consistent approach, are: Rev. Rul. 57-330 (Article 15), Rev. Rul. 59-56 (Article 1), Rev. Rul. 60-313 (Article 14), Rev. Rul. 65-263 (Article 5), Rev. Rul. 66-34 (Article 18), Rev. Rul. 67-321 (Article 5), Rev. Rul. 69-236 (Article 14), Rev. Rul. 70-247 (Article 15), Rev. Rul. 70-382 and Rev. Rul. 72-106 (Article 14), Rev. Rul. 72-301 (Article 20), Rev. Rul. 72-330 (Article 24), Rev. Rul. 72-437 (Article 25), Rev. Rul. 72-460 (Article 18), Rev. Rul. 72-598 (Article 24), Rev. Rul. 73-606 and Rev. Rul. 74-174 (Article 14), Rev. Rul. 74-239 (Article 24), Rev. Rul. 74-330 and Rev. Rul. 74-331 (Article 17), Rev. Rul. 75-10 (Article 14), Rev. Rul. 75-503 (Article 17), Rev. Rul.

76-19 (Article 20), Rev. Rul. 76-121 (Article 18), Rev. Rul. 77-175, Rev. Rul. 77-242, LR 77-30-092 and LR 77-38-017 (Article 14), LR 77-44-036 (Article 17), LR 78-04-086 and LR 78-06-050 (Article 14), LR 78-16-031 (Article 5), LR 79-07-142 and LR 79-11-105 (Article 14), LR 79-13-045 (Article 18), LR 79-19-054 (Article 12), LR 79-28-026 (Article 14), Rev. Rul. 80-15 (Article 12), Rev. Rul. 80-98 (Article 20), Rev. Rul. 80-147 (Article 7), LR 80-30-005 (Article 24), LR 80-36-081 (Article 20), Rev. Rul. 81-78 (Article 7), Rev. Rul. 81-79 (Article 14), Rev. Rul. 81-303 (Article 3), LR 81-13-017 and LR 81-23-106 (Article 14), LR 81-31-059 and LR 81-51-023 (Article 10), Rev. Rul. 83-11 (Article 20), Rev. Rul. 83-144 (Article 24), LR 83-16-109 (Article 5), LR 83-18-010 (Article 5), LR 83-22-010 (Article 14), Rev. Rul. 84-21 (Article 10), Rev. Rul. 84-84 (Article 11), LR 84-19-008 (Article 5), LR 84-39-079 (Article 14), Rev. Rul. 85-4 and Rev. Rul. 85-60 (Article 5), LR 85-12-020 (Article 14), LR 85-24-004 (Article 13), LR 85-37-069 (Article 12), LR 85-43-001 (Article 23), Rev. Rul. 86-156 (Article 7), LR 86-28-071 (Article 14), LR 86-49-036 (Article 14), LR 86-52-018 (Article 17), Rev. Rul. 87-40, LR 88-27-018 and Rev. Rul. 89-5 (Article 20), Rev. Rul. 89-110 (Article 4), LR 89-04-035 (Article 18), LR 89-04-036 (Article 18), Rev. Rul. 90-80 (Article 5), Rev. Rul. 90-101 (Article 3), Rev. Rul. 91-32 (Article 5) and Rev. Rul. 91-58 (which applies to all 38 US tax treaties now in effect as well as the 1975 UK tax treaty at issue – Article 24).

24.09 *Unilateral rulings and estoppel*

Because the tax authorities of one State will typically give a consistent interpretation to a tax treaty term, a taxpayer may argue, vis-à-vis *these* tax authorities (and not those of the other contracting State), that their interpretation of a term in one tax treaty should govern its meaning – at least as regards this tax treaty.

A taxpayer may also argue that tax authorities should give the same interpretation to an identical term in other tax treaties – notably subsequent tax treaties.

If such (estoppel) arguments are accepted, more weight may then be given to a ruling when it is invoked by a taxpayer rather than by tax authorities.

Recommendation 8 of the 1992 ALI Report ends (58): "... a taxpayer should be able to rely on a unilaterally asserted interpretation in his dealings with the country which has adopted that interpretation to the same extent that materials interpreting statutes may be relied upon in controversies concerning domestic law."

This Recommendation 8 impliedly accepts that a taxpayer should not be able to invoke one State's unilateral ruling against another (treaty partner) State. This follows from the principle that a State should only be bound by an interpretation which *it* has agreed to – either unilaterally or in a bilateral context.

Despite its importance to taxpayers, this Recommendation is hardly elaborated upon in the 1992 ALI Report. Furthermore, it is no more than a recommendation. However unfair it may seem, tax authorities may have a duty to assess such tax as the law imposes. Conflicts between fairness and the law have led courts to express different views on estoppel in a tax treaty context – see Chapter 28.19 onwards.

Chapter 25 Legislative histories

Article 32 of the Vienna Convention begins: “Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion ...”

25.01 *What legislative history can be considered and what weight should it be given?*

The preparatory work and circumstances of a tax treaty will include its negotiating history – but not, as Chapter 22.02 makes clear, its legislative history (or histories). Nevertheless, legislative history can be useful supplementary means of interpretation.

The weight to be given to legislative history becomes clearer if the principles governing the weight to be accorded to any supplementary means of interpretation are considered – see Chapter 21.

The application of the good faith principle (i.e. the principle that tax treaties should be interpreted in accordance with the common intention of *both* States – see Chapters 5 and 21.03) means that, at both public international and domestic levels, even publicly available legislative history in one State should not be given excessive weight – because it is, perforce, unilateral. Legislative history in one State may not reflect the views of both States.

The application of the adequate publicity principle (see Chapter 21.04) means that, at a public international level, weight should only be given to such domestic legislative history as both treaty partner States are aware of. At a domestic level, weight should similarly only be given to such domestic legislative history as is made public.

The application of the contemporaneity principle (see Chapter 21.05) reveals that a tax treaty’s legislative history will typically only emerge *after* it has been “finally” negotiated – so that it cannot have been taken into account in prior treaty negotiations. However, it may be appropriate for weight to be given to some post-negotiation legislative history. For example, before a treaty completes its legislative history in State B, State B may publicly and specifically agree with a State A interpretative position explained during this treaty’s State A legislative history – see Chapter 25.06.

25.02 *Does a State permit domestic legislative history to be considered?*

In some States, courts can consider the domestic legislative history of a tax treaty – and they often do so.

For example, Netherlands: *January 26 1977 HR* (Article 18) referred to a note explaining the 1967 UK tax treaty when it was submitted to the Netherlands Parliament for its approval. Because this note only mentioned dividends, interest and royalties as being covered by an anti-avoidance provision, the Hoge Raad held that this provision did not cover a pension – which then avoided tax in both States (see Chapter 11.02).

Netherlands: *June 24 1981 HR* (Article 14) also referred to Netherlands legislative history (as well as subsequent OECD material – see Chapter 26.12).

Netherlands: *July 3 1991 HR* (Article 13) referred to the Netherlands tax authorities’

Explanatory Memorandum on the 1970 Belgium tax treaty, which was expressed as giving the views of both Contracting States – see Chapter 5.

Netherlands: *September 2 1992 HR* (Article 10 and Chapter 23.25) focused on the Commentary on the 1963 OECD Draft – because the Netherlands Government’s explanatory note to the bill introducing the 1969 Ireland tax treaty into Parliament commented that it followed this Draft.

Similarly, the majority in Sweden: *December 23 1987 Supreme Court* (Article 13 and see Chapter 5.04) held that a capital gain was not caught by a comparable anti-avoidance provision – even though, again, this led to tax being avoided in both States. The Supreme Court held that its interpretation was consistent with the fact that the Swedish Government Bill bringing this anti-avoidance provision into force indicated that the scope of the Capital Gains Article would remain unchanged.

Other States’ domestic courts may not be able to refer to a tax treaty’s legislative history. For example, UK domestic courts generally precluded themselves from considering the legislative history of UK statutes (including tax treaties) until the House of Lords 1992 decision in *Pepper v. Hart* – see Chapter 25.03. Courts in Ireland may still preclude themselves from having regard to a statute’s legislative history. As Ward comments (1994, 46): “The pre-*Pepper v. Hart* position still seems to obtain in Ireland [*Edited Footnote 34: See 1993 Kerr [no relation] 72 ...*”

The issue of whether it should be permissible to consider a tax treaty’s UK legislative history has never been a pressing one in the UK – for a simple and, arguably, regrettable reason: so far as my brief researches show, a UK tax treaty typically has no legislative history of consequence. Nevertheless, even prior to *Pepper v. Hart*, there were several reasons why the UK courts’ self-imposed “rule” precluding them from having regard to UK legislative history might not survive intact for long.

Firstly, the “good faith” principle (see Chapter 5) requires a State to interpret a tax treaty in accordance with *both* treaty partner States’ common intention – which may only be ascertainable from a tax treaty’s legislative history.

Secondly, some courts (notably those in the US – see Chapter 25.04) routinely refer to their own legislative histories in interpreting a tax treaty. The greater the extent to which courts in different States consider the same materials, the greater the likelihood that they will interpret a tax treaty consistently. Therefore, a UK court should not preclude itself from considering material which a court in a treaty partner State can consider. In *Fothergill* (see Chapter 3.13) Lord Scarman commented ([1981] A.C. 294): “... uniformity is the purpose to be served by most international conventions It follows that all judges should be able to have recourse to the same aids of interpretation as their brother judges in the other contracting states.” After all, a (UK) court can always disagree with a foreign court’s interpretation – which may, indeed, be incorrect.

Thirdly, courts in Canada and New Zealand (where the legal backgrounds are comparable to that in the UK) are prepared to consider not only domestic but also foreign legislative histories – just as they consider other foreign material (such as

foreign decisions). Courts in these and other States (such as Japan and the Netherlands) view a tax treaty's foreign legislative history as a helpful means of interpretation and as evidence of how a *partner* State interprets a tax treaty – see Chapter 25.13. If courts in treaty partner States are, in principle, prepared to consider UK legislative history, it is anomalous for UK courts to preclude themselves from considering this same UK legislative history.

Fourthly, Article 32 of the Vienna Convention specifically includes “the circumstances of [a tax treaty's] conclusion” as supplementary means of interpretation. UK courts were already prepared to consider some “circumstances of a tax treaty's conclusion” (*i.e.* its background) – notably OECD Models and Commentaries and other tax treaties (see Chapter 23). There is little reason for courts prepared to consider this material – because it evidences the “circumstances of a tax treaty's conclusion” – to preclude themselves from considering other material which also illustrates these circumstances, such as domestic (and foreign) legislative history.

25.03 UK: *Pepper v. Hart*

By 1992, courts in several common law States (including Australia, Canada and New Zealand) were prepared to refer to a statute's domestic legislative history. For example, in *The Queen v. Morrissey* (89 DTC 5080) Canada's Federal Court of Appeal held that excerpts from Canadian House of Commons debates could be used to interpret provisions in the Income Tax Act.

In *Pepper v. Hart* ([1992] STC 898) the House of Lords made it clear that UK courts can now also consider the UK legislative history of a UK statute. *Pepper v. Hart* involved tax legislation that was passed into law after an assurance in Parliament by the Financial Secretary to the Treasury that it would not be applied to a particular situation. So far as is discoverable, this was the intention of Parliament; indeed, some argue persuasively that the legislation would not have been passed without this assurance. Subsequently, the UK Revenue reproduced this assurance in a Press Release. Some years later, for reasons best known to themselves, the Revenue sought to apply the legislation in precisely the way the Minister had said it would not be applied. Seemingly oblivious of the consequences, the Revenue had the misfortune to come before Vinelott J. in the High Court – and to win. The stage was then set for the Revenue's ignominious defeat in the House of Lords – and for a fundamental change in the permissible methods of interpreting UK statutes.

Their Lordships held that account should be taken of the Minister's assurance in Parliament – and they interpreted the legislation in line with this assurance.

As Lord Browne-Wilkinson, expressing the majority opinion, said ([1992] STC 921*d*): “The courts should not deny themselves the light which parliamentary materials may shed on the meaning of the words Parliament has used and thereby risk subjecting the individual to a law which Parliament never intended to enact.” He denied that there was any constitutional impropriety in so doing, commenting ([1992] STC 922*h*): “Recourse is already had to white papers and official reports not because they

determine the meaning of the statutory words but because they assist the court to make its own determination. I can see no constitutional impropriety in this.” Lord Browne-Wilkinson concluded ([1992] STC 927): “Your Lordships are motivated by a desire to carry out the intentions of Parliament in enacting legislation ... The purpose is to give effect to, not thwart, the intentions of Parliament.”

All seven Law Lords accepted the principle underlying the submission by Mr. Lester (counsel for the taxpayer) that the House of Lords should reverse its long-standing rule that no recourse could be had to a UK statute’s legislative history as an aid to interpretation. The sole dissenter (Lord Mackay) objected to Mr. Lester’s submission only on the same grounds – practicality and a very proper (Scottish) regard for cost – that had led to the creation of this judge-made exclusionary rule in the first place.

Mr. Lester successfully submitted that references to parliamentary material as an aid to interpretation were, in Lord Mackay’s words ([1992] STC 903*b*), justifiable: “(a) to confirm the meaning of a provision as conveyed by the text, its object and purpose;

(b) to determine a meaning where the provision is ambiguous or obscure; or

(c) to determine the meaning where the ordinary meaning is manifestly absurd or unreasonable.” These three heads or conditions virtually mirror the key parts of Article 32 of the Vienna Convention (see Chapter 21) – although this provenance was not acknowledged by any of the Law Lords.

Lord Mackay continued ([1992] STC 903*c*): “I believe that practically every question of *statutory* construction that comes before the courts will involve an argument that the case falls under one or more of these three heads. It follows that the parties’ legal advisors will require to study Hansard in practically every such case to see whether or not there is any help to be gained from it.” Lord Mackay observed later ([1992] STC 903*f*, italics added): “The submission which Mr. Lester makes ... is not restricted by reference to the type of statute and indeed *the only way in which it could be discovered whether help was to be given is by considering Hansard itself.*”

These italicised words, and most of the preceding comments apply equally to other supplementary means of interpretation – because the only way to discover whether they can be of help is to consider them.

The questions then arise: when can supplementary means of interpretation be considered – and what weight should be given to them?

Lord Browne-Wilkinson (with whom all the Law Lords (other than Lord Mackay) agreed) held ([1992] STC 923*a*): “... the exclusionary rule should be relaxed so as to permit reference to parliamentary materials where:

(a) legislation is ambiguous or obscure, or leads to an absurdity;

(b) the material relied on consists of one or more statements by a minister or other promoter of the Bill together if necessary with such other parliamentary material as is necessary to understand such statements and their effect;

(c) the statements relied on are clear.”

Condition (a) essentially summarises Mr. Lester’s submission (above); it effectively amounts to the adoption, at a UK domestic level and as regards UK legislative history,

of conditions very similar to those permitting the use of supplementary means of interpretation under Article 32 of the Vienna Convention.

It is difficult to avoid the conclusion that, just as any material which can aid interpretation is supplementary means of interpretation at a public international level, so it is at a UK domestic level. To the question: “where do you stop?” there is only one answer. You only stop when you have analysed all relevant and permissible means of interpretation – in the light of the comments in Chapter 21.

Whilst the result in *Pepper v. Hart* was clearly “fair”, it may come to be seen as a classic illustration of the maxim “good cases make bad law”. Some regret the fact that the Revenue’s “unfair” stance may lead to a less textual approach to statutory interpretation. Many anticipate that the administration of justice in the UK may proceed yet more slowly.

One implication of *Pepper v. Hart* is clear: if a UK tax treaty ever acquires a UK legislative history of any consequence, UK courts should now be able to consider it – because a UK tax treaty is a UK statute. Furthermore, because a tax treaty should be interpreted in accordance with the intentions of both States, it may also be appropriate for UK courts (in common with Canadian and New Zealand courts) to consider legislative histories in treaty partner States.

However, legislation may have to be introduced to restrict the circumstances in which Counsel may refer to a UK statute’s legislative history – for the two reasons underlying Lord Mackay’s objection (see above). Firstly, researching a statute’s Parliamentary history is difficult; few libraries stock Hansard (the official report of UK Parliamentary proceedings) – and even Hansard may not reveal all Ministerial assurances and “back of the envelope” political compromises. Secondly, such research will considerably increase the cost of litigation – much of which is borne by the State through the legal aid scheme.

In any event, the Revenue should be forced to publicise all Ministerial statements – and, in a self-denying ordinance, should commit itself to follow such statements and any of its Press Releases. Furthermore, in a type of “estoppel” (see Chapter 28.19 onwards), the remedy of judicial review should be made easily available when the Revenue does not honour such a commitment.

25.04 US (post-negotiation) legislative history

US courts and tax authorities routinely (and perhaps excessively – see below) consider the US legislative history of US tax treaties. There are three reasons for this.

Firstly, US principles of statutory construction have long permitted this approach in relation to domestic legislation – see Sutherland (1992 Section 49.05). In other jurisdictions, different principles may apply – see Chapter 25.02.

Secondly, US courts have long recognised that all available evidence as to the meaning of a treaty term must be examined.

Thus, in the Court of Appeals in US: April 29 1963 *Maximov* (Article 4 and see Chapters 6.06 and 12.03), Clark J. commented (299 F.2d 568, italics added): “... to

give the specific words of a treaty a meaning consistent with the genuine shared expectations of the contracting parties, it is necessary to examine not only the language, but the entire context of agreement. *We must therefore examine all available evidence of the shared expectations of the parties to this Convention ...*”

The third reason why US courts routinely consider US legislative history in relation to tax treaties is that, in the US, tax treaties *have* a legislative history – which is readily accessible. In other jurisdictions, such as the UK, a tax treaty’s domestic legislative history will often be sparse – if not non-existent – and comparatively inaccessible.

Nevertheless, a tax treaty’s domestic legislative history in the US (and other jurisdictions) will typically be generated only after the competent authorities have negotiated the “final” text of a tax treaty.

For example, the US Treasury Department will only make public its written understanding of the principal provisions of a tax treaty after it has been “finally” negotiated. It will normally do this prior to the Senate’s public debate on this tax treaty. This debate offers some opportunity for the intended meaning of terms in a tax treaty to be clarified, prior to its ratification by the President. Some argue that the US treaty-making process places treaty partner States at a disadvantage – because the US Senate can take a “second look” at a tax treaty after it has been “finally” negotiated. The fact that the President may decline to ratify a tax treaty which has been approved by the Senate is, arguably, an opportunity for yet another (third) “look”.

25.05 *Should US courts consider a tax treaty’s unilateral US legislative history?*

In common with US tax authorities, US courts have often considered a tax treaty’s post-negotiation, pre-ratification, US legislative history to be determinative as to the meaning of its terms. Some US courts have focused on unilateral US material generated during this history to such an extent that they have virtually ignored the ordinary meaning of a tax treaty’s words – let alone the parties’ “shared” expectations.

The 1992 ALI Report comments (27): “... in at least one respect it would be desirable if US interpretation practice conformed more closely to that of the Vienna Convention. On balance, US practice appears to place undue weight on unilateral interpretative materials, as opposed to materials that are the product of or otherwise reflect the mutual views of both parties to a bilateral convention.”

Recalling the (minority) view of Justice Scalia in US: February 28 1989 *Stuart* (Article 26 and see Chapter 25.11), this ALI Report then expresses (47, footnote 153) concern about reliance on unilateral, post-negotiation, materials – such as Senate debates.

Despite these comments, post-negotiation material is still likely to be referred to in US Revenue and Letter Rulings – because tax authorities tend to interpret tax treaty terms consistently (see Chapter 24.07). US courts may, however, take a different line – and overrule such Rulings (see Chapter 28.18).

25.06 *Can unilateral post-negotiation US legislative history be considered bilateral?*

Once the US Treasury's Technical Explanation of a tax treaty has been made publicly available – after this treaty has been “finally” negotiated – the US Treasury will occasionally send it to a treaty partner State. Even more occasionally, a treaty partner State will indicate that it agrees with such an Explanation.

For example, in its February 4 1981 Release No. 81-6, Canada's Department of Finance commented that the 1980 US Technical Explanation of the 1980 US tax treaty accurately portrayed both parties' understanding of this treaty. Following revisions to this treaty, the US Treasury Department then issued an April 26 1984 Revised Technical Explanation – which was referred to in Canada: February 18 1991 *Wuslich* (Article 7) by Rowe T.C.J. He commented that this 1984 Explanation was (91 DTC 713) “endorsed by the Canadian Department of Finance on August 26, 1984” and (91 DTC 717) “adopted by Canada”.

At a public international level, Canada's agreement with these US Technical Explanations would seem to make them conclusive means of interpretation – because they have been agreed to by both States.

At a domestic level, however, the status of these Technical Explanations is less clear – even if they are interpreted correctly. Incorrectly interpreted, they are useless. In *Wuslich*, for example, the Canadian tax authorities incorrectly interpreted the 1984 US Revised Technical Explanation – so it was of no use to them.

The 1992 ALI Report recommends that if a treaty partner State formally recognises that it agrees with, say, a US Treasury Department Technical Explanation, this Explanation should normally be conclusive at a domestic level. Its Recommendation 3 runs (48): “Unless contrary to the express language of the treaty itself, material relevant to treaty interpretation which is published by one of the countries in connection with the negotiation or ratification of the treaty should ordinarily be conclusive if it is established that the other country, prior to the ratification of the treaty, was in agreement with the positions expressed in that material.”

The 1992 ALI Report also recommends that even if a treaty partner State does not acknowledge receipt of such contemporaneous unilateral material, it should be given substantial weight *in the State generating this unilateral material*. Its Recommendation 6 runs in part (52 and 53): “6. In treaty interpretation, substantial weight should ordinarily be given to relevant portions of: ... (b) Material published unilaterally prior to or contemporaneously with the ratification of the treaty by the country whose taxing authority is in issue, which has neither been accepted nor objected to by the other treaty country”.

The 1992 ALI Report comments (54): “... a country's unilateral interpretation seems particularly persuasive when it describes the effect of the treaty on its own power to tax, since it has a direct interest in what it “gave up” in entering into the treaty”. However, in view of “the potential for one-sidedness”, “great significance should be attributed to whether a contrary view had been taken by the other treaty country and whether the materials contradict common understanding, as evidenced, for example, by the OECD Commentary.”

These cautionary remarks may be too cautious. US courts have already accorded excessive weight to US legislative history – see Chapter 25.09 onwards. This runs counter to the “good faith” principle – which requires a (tax) treaty to be interpreted in accordance with the common intention of *both* States (see Chapter 5).

25.07 US Revenue and Letter Rulings frequently refer to US Governmental materials

There are numerous examples of material generated during the US treaty-making process being referred to in US Revenue and Letter Rulings.

Reports by the Department of State to the Senate are referred to in Rev. Rul. 70-614 (Article 24) and LR 85-37-069 (Article 12 and see below).

Technical Memoranda, Explanations or comments by the Treasury Department are referred to in Rev. Rul. 77-242 (Article 14); LR 79-52-097 (Article 20), LR 80-04-139 (Article 11), LR 80-42-082 (Article 10), LR 81-25-100 and LR 81-41-108 (Article 11), LR 85-24-009 and LR 85-43-001 (Article 23), LR 87-14-055 (Article 24), LR 87-47-006 (Article 21), LR 87-48-003 (Article 15), Rev. Rul. 89-95 (Article 18), LR 92-53-049 (Article 21) and LR 93-30-006 (Article 10).

LR 84-52-091 (Article 21) holds that because the term “pension” was not defined in the 1975 UK tax treaty, the definition in the Treasury Technical Explanation should be adopted. Although LR 84-52-091 does not mention the fact, Article 3(2) of this treaty is very similar to Article 3(2) of the 1981 US Model (which is wider than the 1977 OECD Model – see Chapters 7.04, 10.01 and 27.05).

In LR 87-14-055 (Article 24) the taxpayer argued that because his “interpretation is the “plain meaning” of the Article, the IRS should not refer to the Treasury Technical Explanation or any other legislative history to arrive at another meaning. *See, e.g., Malat v. Riddell*, 383 U.S. 569 (1966).” LR 87-14-055 nevertheless holds that this Technical Explanation correctly interpreted the 1980 Canada tax treaty.

Memoranda from the Staff of the Joint Committee on Internal Revenue Taxation are referred to in Rev. Rul. 72-437 (Article 25), LR 80-42-082 (Article 10) and LR 87-50-014 (Article 8).

Oral testimony by the Chairman of the Joint Committee on Internal Revenue Taxation was cited, firstly, in LR 85-37-069 (Article 12) – and then again, to different effect, in Rev. Rul. 86-156 (Article 7).

LR 85-37-069 interpreted the Supplementary Convention to the 1948 Netherlands tax treaty in the light of a letter from the Secretary of State transmitting it to the Senate, and testimony by Mr. Laurence N. Woodworth (the Chief of Staff of the Joint Committee on Internal Revenue Taxation) before the Senate Foreign Relations Subcommittee on Tax Conventions. Rev. Rul. 86-156 then also analysed this letter – but holds that it does not mean what LR 85-37-069 held it to mean. Rev. Rul. 86-156 holds that its interpretation is more consistent with “the legislative history and historical circumstances” applicable to the 1948 Netherlands tax treaty.

Senate Executive Reports (which could incorporate any of the above material) are referred to in Rev. Rul. 79-28 (Article 23), Rev. Rul. 81-78 (Article 7), Rev. Rul. 85-

76 (Article 29 and see Chapter 28.03), LR 86-45-001 (Article 19) and LR 87-50-014 (Article 8).

25.08 US rulings refer to legislative material on existing and subsequent tax treaties

US rulings have also referred to post-negotiation materials involving other tax treaties – including many which post-date the tax treaty being interpreted. Some examples of this material are given below.

US: Rev. Rul. 56-164 (Article 14), interpreting the 1948 Netherlands tax treaty, refers to the Treasury Department's Technical Memorandum on the 1945 UK tax treaty.

US: Rev. Rul. 69-327 (Article 23), interpreting the 1954 Japan tax treaty, refers to a memorandum from the Joint Committee on Internal Revenue Taxation which forms part of the Senate Foreign Relations Committee's Report on the 1945 UK tax treaty.

US: Rev. Rul. 72-301 (Article 20), interpreting the 1957 Pakistan tax treaty, refers to Treasury Department comments on the 1939 Sweden and 1962 Luxembourg tax treaties.

US: Rev. Rul. 72-330 (Article 24), interpreting all tax treaties, refers to the Technical Explanations submitted by the Treasury Department to the Senate Foreign Relations Committee in relation to the 1970 Belgium, 1970 Trinidad and Tobago and 1971 Finland tax treaties.

US: Rev. Rul. 72-437 (Article 25), interpreting numerous tax treaties, refers to the Senate Executive Report and the Memorandum from the Joint Committee on Internal Revenue Taxation in relation to the 1954 Germany tax treaty.

US: Rev. Rul. 74-239 (Article 24), interpreting the 1942 Canada tax treaty, refers to the Memoranda prepared by the Joint Committee on Internal Revenue Taxation which accompanied the 1971 Japan, 1971 Norway and 1967 France tax treaties when they were considered by the Senate Foreign Relations Committee.

25.09 Some US courts refer to US legislative history

There are numerous recent examples of US courts referring to domestic unilateral materials which post-date the negotiation of the "final" tax treaty text.

In US: March 25 1955 *Lewenhaupt* (Article 25) Harron J. referred (20 T.C. 160) to the Senate Executive Report on the 1939 Sweden tax treaty – see Chapter 28.15.

In US: October 22 1975 *Burbank* (Article 26) the IRS referred to the Senate (post-negotiation) debate on the 1942 Canada tax treaty. This same debate was also referred to in the Supreme Court in US: February 28 1989 *Stuart* (Article 26) – when different views were expressed as to the weight this debate deserved (see Chapter 25.11).

US: May 27 1980 *Filler* (Article 25) cited a Senate Executive Report.

In US: May 5 1982 *Great-West* (Article 7) Kashiwa J. held that the purpose of the tax treaty should override its clear literal wording – see Chapter 6.06. He commented (678 F.2d 188): "... the ultimate question remains what was intended when the language actually employed in Article XII was chosen, imperfect as that language may be. As we

have set out in Part IV, that language, when understood in light of the treaty's history and explanatory provisions, effected only a waiver of US taxes imposed solely through the deemed sourcing provisions on those not present in the US."

In making his holding, Kashiwa J. relied upon post-negotiation US materials (such as the Report by the Senate Committee on Foreign Relations, and the transmittal letter from the Acting Secretary of State to the Senate) and comparable unilateral interpretations of other tax treaties by the Department of State and the Treasury. Even less convincingly, he also relied upon the reactions of Canadian life insurance companies and Congress to a change in US legislation.

Germany: *October 9 1985 BFH* and UK: February 9 1990 *Commerzbank* (both Article 7) each declined to follow *Great-West's* criticised approach – see Chapter 6.05.

As Chapter 6.07 indicates, the 1992 ALI Report recommends (46) that *Great-West's* approach be used "extremely sparingly"; it notes (46, footnote 152): "This approach is squarely inconsistent with the rules of the Vienna Convention."

In US: April 11 1983 *Burghardt Estate* (Article 3 and see Chapter 10.11) the US tax authorities placed great emphasis on the analysis of the 1955 Italy estate tax treaty by the Joint Committee on Internal Revenue Taxation for the Senate Foreign Relations Committee. Tannenwald J. also considered this Joint Committee analysis – but held that it supported the taxpayer's argument, not that of the US tax authorities.

Tannenwald J. also considered the legislative histories of several other earlier US estate tax treaties, notably those with Canada, Greece and France – see Chapter 23.21.

Great-West's approach was followed in US: March 17 1988 *Xerox* (Article 23), when Futey J. made little attempt to analyse *Xerox's* claim by studying the words of the 1975 UK tax treaty – see Chapter 27.18. He focused instead on the US Technical Explanation, commenting (14 Cl.Ct. 463): "The Technical Explanation reveals the intent of Treasury with respect to the Convention and, as numerous federal courts have stated, "the meaning attributed to treaty provisions by the Government agencies charged with their negotiation and enforcement is entitled to great weight." *Sumitomo Shoji America, Inc. v. Avagliano*, 457 U.S. 176, 184-85, 102 S.Ct. 2374, 2379, 72 L.Ed.2d 765 (1982); *See also Kolovrat v. Oregon*, 366 U.S. 187, 194, 81 S.Ct. 922, 6 L.Ed.2d 218 (1961)); *Great-West Life Assurance Co. v. US* [above], 230 Ct.Cl. 477, 491, 678 F.2d 180, 189 (1982)."

In US: April 20 1994 *Barquero* (Article 26) Judge Vela in the District Court interpreted the 1989 Mexico TIEA (exchange of information agreement) by reference to the Report of the Committee on Foreign Relations on the earlier 1988 Bermuda TIEA – see Chapter 23.21.

25.10 US courts frequently consider that US unilateral materials have become bilateral

In *Xerox*, Futey J. also held (mistakenly) that the US Technical Explanation on the 1975 UK tax treaty had become bilateral. He commented (14 Cl.Ct. 463 and 464, footnote 4 omitted): "... the record indicates at least tacit acceptance by the UK of the US interpretation of Article 23(1)(c) as set forth in the Technical Explanation. As

stated in the affidavit of Steven P. Hannes, who was a member of the US negotiating team in 1975 and an attorney for Treasury during the US Senate's consideration of the treaty, "copies of the Technical Explanation would have been sent to the UK negotiators." Knowledge of the US interpretation, therefore, was clearly before the House of Commons during its own ratification debate. The UK ratified the Convention in the form approved by the US Senate, without further reservation or amendment, by enacting section 16 of the Finance Act (No. 2) 1979, dated July 26, 1979."

Futey J. later addressed contrary arguments by the plaintiff (Xerox) commenting: (14 Cl.Ct. 466): "The Technical Explanation is characterized by plaintiff as a vehicle by which Treasury attempted not just to explain the treaty's contents, but "to legislate its changing views of what it believes should have been added to the treaty." "

Xerox also argued that Rev. Proc. 80-18 was invalid – see Chapter 28, and that a competent authority agreement was "weak on content" – see Chapter 27.18.

Futey J. held (14 Cl.Ct. 466): "The court, however, does not share plaintiff's dim view of these documents. As previously discussed, Treasury's Technical Explanation was presented to the US Senate as an aid to its understanding of the treaty articles, and the Senate's intent in ratifying the Convention was clearly shaped thereby. In view of the UK's subsequent ratification of the Convention without reservation, and with full knowledge of the Technical Explanation underlying the US ratification, it is difficult to sustain plaintiff's assertion that the Technical Explanation did not conform with the terms of the treaty."

To conclude (as Futey J. did) that this Technical Explanation was "clearly before the House of Commons during its own ratification debate" is to misunderstand the essentially passive role of the House of Commons in the UK treaty-making process – where little, if any, legislative history of consequence is generated. Indeed, at that time, such history was not even admissible evidence in UK courts – see Chapter 25.03.

Furthermore, although the US Treasury had sent its Technical Explanation to the UK, there is no evidence that the UK negotiators ever considered it – let alone approved it.

Futey J.'s comments in *Xerox* echo Judge Bryan's view in *Samann* (see Chapter 28.14) that a treaty partner State which does not object to US post-negotiation materials submitted to it has "at least tacitly" approved them.

This view is not shared by the 1992 ALI Report. It comments (36, footnotes omitted) that this view: "... goes too far. Even a conscientious negotiator cannot justly be charged with agreeing with everything that passes over his desk unless he makes a specific protest. If a treaty partner expressly agrees with a US Technical Explanation, this should represent an agreement of the contracting parties which is to be given effect. But agreement should not be inferred from mere passivity."

25.11 *Conflicting views in the US Supreme Court*

In US: February 28 1989 *Stuart* (Article 26) conflicting views were expressed in the Supreme Court as to whether extra-textual material, such as a tax treaty's legislative history, could be relied upon.

Justice Brennan's majority opinion held that reliance on the Senate's pre-ratification debates and reports on the 1980 Canada tax treaty was (103 L Ed 2d 405 Footnote 7) not "improper" and was "eminently reasonable". Justice Kennedy (with whom Justice O'Connor agreed) held that because the text of this treaty was clear, *Stuart* could be resolved without recourse to this treaty's legislative history. Justice Scalia held similarly – but he disapproved of recourse being had to this treaty's legislative history.

Justice Scalia commented (103 L Ed 2d 408 and 409): "... our traditional rule of treaty construction is that an agreement's language is the best evidence of its purpose and its parties' intent. ... That is the governing principle of interpretation. Only when a treaty provision is ambiguous have we found it appropriate to give authoritative effect to extra-textual materials."

Justice Scalia continued (103 L Ed 2d 409): "Even, however, if one generally regards the use of preratification extrinsic materials to confirm an unambiguous text as an innocuous practice, there is special reason to object to that superfluous reference in the present case. What is distinctive here is the nature of the extra-textual materials to which the Court unnecessarily refers. To discover Canada's and the US' "intent and expectations," the Court looks solely to the US Senate floor debates that preceded the President's ratification of the treaty. Ante, at – 103 L Ed 2d 404-405 and nn 7-8. The use of such materials is unprecedented. Even where the terms of the treaty are ambiguous, and resort to preratification materials is therefore appropriate, I have been unable to discover a single case in which this Court has consulted the Senate debate, committee hearings or committee reports. It would be no more appropriate for me than it is for the Court, to use the present case as the occasion for pronouncing upon the legitimacy of using such materials, but it is permissible to suggest some of the arguments against it. Using preratification Senate materials, it may be said, is rather like determining the meaning of a bilateral contract between two corporations on the basis of what the Board of Directors of one of them thought it meant when authorizing the Chief Executive Officer to conclude it. The question before us in a treaty case is what the two or more sovereigns agreed to, rather than what a single one of them, or the legislature of a single one of them, thought it agreed to. And to answer that question accurately, it can be reasonably said, whatever extra-textual materials are consulted must be materials that reflect the mutual agreement (for example, the negotiating history) rather than a unilateral understanding."

Giving the majority opinion in the Supreme Court, Justice Brennan disagreed with this contractual analogy by Justice Scalia. He commented (103 L Ed 2d 405 Footnote 7): "Senate debates do not occur behind closed doors, out of earshot of proposed treaty partners, nor are preratification Senate reports kept under seal. Both are public statements. They therefore bear no resemblance to the private deliberations of a Board of Directors prior to the Board's decision whether to authorize the Chief Executive Officer to sign an agreement. Insofar as the contract analogy is apt, the better comparison is to a meeting of the Board whose minutes and position papers the other corporation's Board and Chief Executive Officer are invited to peruse. It is hornbook

contract law that the proper construction of an agreement is that given by one of the parties when “that party had no reason to know of any different meaning attached by the other, and the other had reason to know the meaning attached by the first party.” Restatement (Second) of Contracts Section 201(2)(b) (1981). See also E. Farnsworth, *Contracts* 487-488 (1982). A treaty’s negotiating history, which Justice Scalia suggests would be a better interpretive guide than preratification Senate materials, see post, at –, 103 L Ed 2d 409, would in fact be a worse indicator of a treaty’s meaning, for that history is rarely a matter of public record available to the Senate when it decides to grant or withhold its consent.”

Later in his judgment, Justice Scalia referred to the ALI’s *Restatement (Third) of the Foreign Relations Law of the US*. He commented (103 L Ed 2d 410 and 411): “The American Law Institute’s Restatement of the Foreign Relations Law of the US would permit the courts to refer to materials of the sort at issue here. See Restatement (Third) of the Foreign Relations Law of the US Section 314, Comment d (1986); id., Section 325, Reporter’s Note 5. But despite the title of the work, this must be regarded as a proposal for change rather than a restatement of existing doctrine, since the commentary refers to not a single case, of this or any other US court, that has employed the practice. The current version of the Restatement provides no explanation for (or even acknowledgment of) this curiosity. An explanation was provided in the Proposed Official Draft of the Second Restatement, which is of some interest: “There is virtually no precise decisional authority on this matter, probably because of the domestic interpretative rule, stated in Section 155, that executive interpretations of international agreements are given great weight by courts in the US or because, as explained in Comment a to this Section, the courts wish to avoid if possible creating disharmony between the international and the domestic meanings of international agreements.” Restatement of the Foreign Relations Law of the US Section 154, Comment b(ii) (Prop Off Draft 1962).

This is not the case in which to commit ourselves to an approach that significantly reduces what has hitherto been the President’s role in the interpretation of treaties, and commits the US to a form of interpretation plainly out of step with international practice.”

25.12 US: August 13 1992 *Snap-On* (Article 23)

In a welcome development, which may be reversed by general legislation, *Snap-On* effectively distinguishes *Xerox*’s extra-textual approach to tax treaty interpretation. The approach in *Snap-On* (a decision which was simply affirmed by the US Court of Appeals for the Federal Circuit on April 7 1994) is closer to the textual approach in UK: February 9 1990 *Commerzbank* and Germany: October 9 1985 *BFH* – which similarly distanced themselves from the approach in US: March 5 1982 *Great-West* (which *Xerox* cited as authority); these last three decisions are all analysed in Chapters 6.05 to 6.07.

Snap-On involved the 1975 UK tax treaty, and whether it overruled the 60-day rule

in s.902(c)(1) IRC (which has since been specifically overruled by *statute*, as indicated below). The 60-day rule allowed corporations to treat dividends paid within 60 days of the end of a taxable year as having been paid out of that taxable year's profits. After approving Justice Scalia's approach in *Stuart* (which he summarised as "[the] language of the agreement is the best evidence of the intent of the parties and the purpose of the treaty"), Horn J. commented (26 Cl.Ct. 1066, footnote 21 omitted): "... the clear intent of both parties should not be ascertained from the Technical Explanation to the US-UK Income Tax Convention on which the defendant relies so heavily in support of its position. There simply is not evidence in the record, as is discussed more fully below, to support the notion that the British government was aware that the words of the US-UK Income Tax Convention were intended to change the 60-day rule. The Convention is silent regarding any change to the 60-day rule, although it is not silent that existing US income tax provisions, not addressed by the Convention, presumably including IRC section 902(c)(1), should apply and remain in effect following the effective date of the Convention."

Horn J. held later (26 Cl.Ct. 1068): "This court believes that no language included in the US-UK Income Tax Convention expressly overrules, or was intended to overrule, the statutory provisions of IRC section 902(c)(1). However, this Opinion also addresses the available preparatory, extra-textual materials to the US-UK Income Tax Convention, including the Technical Explanation, which is the only document in the preparatory materials to specifically address the 60-day rule. The court observes that the notes of the negotiators to the US-UK Income Tax Convention, the official protocols to the Convention, and the Competent Authority Agreement, all are silent on the 60-day rule. In fact, the defendant admits by stipulation that the official notes of the negotiating sessions in which Articles 10 and 23 of the US-UK Income Tax Convention are discussed contain no reference whatsoever to either the details of the credit for the ACT or of the application of the 60-day rule.

The Technical Explanation was prepared in March 1977, and submitted to the Senate Foreign Relations Committee to assist in the considerations of the US-UK Income Tax Convention by the US Senate. Although this document may be viewed as part of the Convention preparatory materials, it was prepared for the US Senate for use in the ratification process. It was not part of the contemporaneous history of the bilateral negotiations between the US and the UK, which resulted in the signing of the Income Tax Convention, but was prepared after conclusion of the negotiations. [Footnote 22: The parties have stipulated that: "[T]he position that the Department of the Treasury takes in the Technical Explanation respecting the applicability of the "60-day rule" of Section 902(c), Internal Revenue Code of 1954, under the Treaty appears to have been developed by Treasury Department personnel some time between November 1, 1976 and March 1, 1977."]

Horn J. noted that these dates were months after the December 31 1975 date on which this UK tax treaty was signed. He then continued (26 Cl.Ct. 1069): "The chronology of events leading up to ratification of the US-UK Income Tax Convention

are pertinent in determining the weight of the preparatory materials. On December 31, 1975, the US-UK Income Tax Convention was signed. The State Department transmitted the US-UK Income Tax Convention to the President, and on June 24, 1976, the President submitted the Convention to the Senate. In mid-July, 1977, the Department of the Treasury submitted the Technical Explanation of the US-UK Income Tax Convention to the Senate Foreign Relations Committee for use during the hearing on the Convention held on July 19-20, 1977. On April 25, 1978, the Senate issued Executive Report No. 95-18, regarding the Senate's consideration of the US-UK Income Tax Convention. On June 17, 1978, the Senate voted its advice and consent to the US-UK Income Tax Convention and did not attach any reservation regarding the 60-day rule to its ratification. Instruments of ratification were exchanged on March 25, 1980, and the Convention became effective following 30 days thereafter, on April 25, 1980."

Horn J. continued later (26 Cl.Ct. 1070): "The defendant, however, relies heavily on the Technical Explanation, the only relevant document containing a reference to the 60-day rule, to plug the alleged loophole, denominated by the parties as the "gap," in the US-UK Income Tax Convention, given the silence of the Convention on the 60-day rule. The defendant urges this court to follow the position taken in *Xerox Corp. v. US* [US: March 17 1988 *Xerox* – Chapter 25.10], 14 Cl.Ct. 455 (1988), on the issue of the weight to be accorded the Technical Explanation. This court is persuaded, however, that the *Xerox* case is not dispositive of the issue currently before the court."

Horn J. continued later (26 Cl.Ct. 1071 and 1072): "This court does not take issue with certain of the principles articulated in *Sumitomo Shoji America, Inc. v. Avagliano* and relied on by the *Xerox* court, as follows: "Although not conclusive, the meaning attributed to treaty provisions by the Government agencies charged with their negotiation and enforcement is entitled to great weight. *Kolovrat v. Oregon*, 366 U.S. 187, 194 (1961)." *Xerox Corp. v. US*, 14 Cl.Ct. at 463 (citing *Sumitomo Shoji [America,] Inc. v. Avagliano*, 457 U.S. at 184-85, 102 S.Ct. at 2379). This court also agrees with the *Sumitomo* court that: "Our role [the role of the US Supreme Court] is limited to giving effect to the intent of the Treaty parties. When the parties to a treaty both agree as to the meaning of a treaty provision, and that interpretation follows from the clear treaty language, we must, absent extraordinarily strong contrary evidence, defer to that interpretation." *Sumitomo Shoji America, Inc. v. Avagliano*, 457 U.S. at 184-85, 102 S.Ct. at 2379 (emphasis added).

In *Sumitomo*, the Supreme Court discussed the importance of endorsing the meaning attributed to the treaty provisions by both parties to the treaty. The history of the US-UK Income Tax Convention, however, does not evidence a conscious repeal of the 60-day rule by both signatories to the Convention. In fact, there is evidence in the record to suggest that neither the Americans nor the British were expecting the Convention to repeal the 60-day rule. Although the Technical Explanation was before the US Senate when it ratified the US-UK Income Tax Convention, there is no indication in the legislative record that the Senate members, when voting, were aware that the effect of

ratifying the Convention would be to repeal the 60-day rule. No reservations were attached to the ratification by the Senate. This court, therefore, is not persuaded, as was the *Xerox* court, that: “it is logical to conclude that the Senate was in accord with Treasury Department’s interpretation of Article 23 as set forth in the Technical Explanation when it ratified the US-UK Income Tax Treaty in 1978-79.” *Xerox Corp. v. US*, 14 Cl.Ct. at 463.

... The *Xerox* court appears to have taken the position that since the UK voiced no objection to the Technical Explanation, the UK “tacitly” accepted the provisions articulated in the Technical Explanation. This court believes, however, that an understanding of a position which forms the basis for a negotiated international agreement cannot be arrived at “tacitly,” but must be achieved consciously and deliberately by both parties.

Moreover, there is no positive evidence in the record that the UK intended the US-UK Income Tax Convention to bar the application of the 60-day rule included in IRC section 902(c)(1).”

Horn J. concluded (26 Cl.Ct. 1073): “Therefore, given the apparent absence of agreement by the parties on a repeal of the 60-day rule (a question not at issue in the *Xerox* case), this court looks to the words of the US-UK Income Tax Convention, which is silent on the 60-day rule. Therefore, the Convention directs the taxpayer back to the applicable US Tax Code provisions, which, for plaintiff’s applicable tax years, includes the 60-day rule.”

Horn J. also held that an IRS Revenue Procedure “backing” the Technical Explanation had no precedential value – see Chapter 28.17.

25.13 A treaty partner State’s legislative history may even be referred to

Any reference to a treaty partner State’s legislative history recognises the importance of interpreting tax treaty terms on a reciprocal, consistent basis. The application of a treaty partner State’s unilateral legislative history amounts to giving this history a bilateral application. As indicated above, references to a treaty partner State’s legislative history have been made in Canada and New Zealand.

In Canada: February 19 1992 *Utah Mines* (Article 7), the Canadian tax authorities referred to, and Walsh D.J. (in the Tax Court) considered (91 DTC 5250), the US Senate Foreign Relations Committee Report on the 1942 US tax treaty at issue. The Canadian tax authorities also referred to US: January 17 1955 *Handfield* (Article 5) which Walsh D.J. also cited – see Chapter 29.08. In the Federal Court of Appeal, Hugessen J.A. based his judgment on the “purpose” of the tax treaty (see Chapter 11.10) and referred to its preambles (see Chapter 14.01) and its 1950 amending Convention. Hugessen J.A. then commented (92 DTC 6196): “The purpose of the sentence added to paragraph 1 of article III by the amending Convention of 1950 is stated even more specifically, and the amendment itself is put in context, in the Presidential Message to the US Senate seeking that body’s ratification of the Convention” – part of which he then cited.

According to Nakazato (1993, 414, Footnote 26) Japan: *April 14 1965 Tokyo District Court* also referred to a US Senate Executive Report in interpreting the 1954 US tax treaty, and relied upon its English text (see Chapter 20.04).

Netherlands: *November 4 1992 HR* (Article 13) referred to the Swiss Explanatory Note when the 1966 Supplementary Convention was considered by the Swiss Parliament. This Note clarified that the words “capital stock” meant issued stock.

In New Zealand: June 14 1990 *JFP Energy* (Article 15 and see Chapters 3.07 and 24.06) the Court of Appeal, acknowledging the need for consistent interpretations of tax treaty terms, considered the 1982 US treaty’s US legislative history.

Richardson J. commented (12 NZTC 7,181): “Counsel referred us to various commentaries and explanations by governmental authorities in various jurisdictions. In our opinion and with one exception that material is too insubstantial to be taken into account. The exception relates to the Treasury Department’s Technical Explanation of the Agreement tendered to the Senate Foreign Relations Committee for the purposes of gaining the advice and consent of the Senate to that Treaty. The Technical Explanation records that it is an official guide to the Convention. It reflects policies behind particular Convention provisions, as well as understandings reached with respect to the interpretation and application of the Convention. ...

It is well established following New Zealand’s commitment to CER that commercial legislation applicable to Australia/New Zealand transactions should in the ordinary course be accorded the same interpretation on either side of the Tasman. For similar reasons it is obviously desirable that the same interpretation answer should be given whether a double taxation treaty question arises for determination in New Zealand or the US and in our view appropriate consideration should be given to the considered official opinion of the other party to the treaty as to its meaning. In this case that Treasury pronouncement reinforces the conclusions we have reached as to that meaning.”

Somers J. concluded (12 NZTC 7,182): “The Agreement is intended to avoid double taxation. That object will obviously not be achieved unless the construction put on it is the same in each state. The material before us is not entirely clear but appears to me to indicate that in the US what is actually done by the employer is the determining feature. The conclusion I have reached is the same.”

25.14 Estoppel

If a tax treaty’s legislative history can be considered, taxpayers should be entitled to rely on interpretations given to terms in a tax treaty in the course of its legislative history. This was the effect of the UK House of Lords decision of *Pepper v. Hart* – discussed in Chapter 25.03. This entitlement is stronger than, but comparable to, an estoppel argument – see Chapter 28.19 onwards.

Chapter 26 Subsequent tax treaties and OECD materials

In line with the contemporaneity principle of interpreting supplementary means of interpretation (see Chapter 21.05), all subsequent material should be treated with caution. Subsequent material, however prestigious (see Chapter 21.02), cannot have been in the contemplation of treaty partner States when they negotiated their tax treaty.

Nevertheless, subsequent bilateral material (notably subsequent tax treaties) may be helpful supplementary means of interpretation.

Some subsequent multilateral material (notably OECD Models and their Commentaries) may also be helpful supplementary means of interpretation.

26.01 *Subsequent tax treaties or Models may elucidate earlier tax treaties*

Although subsequent tax treaties or Models cannot have been in the minds of treaty negotiators, slightly different wording in them may elucidate the meaning of a term in an earlier treaty – especially when no change of meaning is indicated.

As tax treaties (and the Models on which they are based) have evolved, they have become more detailed and comprehensive. Their ever-increasing lengths, a particular feature of recent US tax treaties, often reflect attempts to clarify insufficiently defined terms in earlier treaties and resolve issues which have arisen in relation to them. Most of these attempts are to be encouraged. The more tax treaty terms are defined, the less frequently will undesirable references to domestic law be necessary (see Chapter 8.14).

The question arises: should earlier tax treaties be interpreted as if they contained clarifications and/or amplifications in subsequent Models or tax treaties?

In Belgium: *October 12 1973 CC* (Article 10) the Cour de Cassation found the (later) August 29 1967 UK tax treaty, and an (earlier) March 7 1967 letter from the Belgian Minister of Foreign Affairs to the Swedish Ambassador to Belgium, to be of assistance in interpreting the April 11 1967 Germany tax treaty.

In Canada: February 16 1971 *Western Electric* (Article 12) the taxpayer argued that the “narrow” 1942 US tax treaty should not be interpreted as being as “broad” or “extended” as subsequent tax treaties – which did explicitly include know-how payments in their definitions of royalties. Dumoulin J. commented (69 DTC 5212) that this argument was: “A fair suggestion, undeniably, but perhaps open to the retort that the Minister’s intention to tax scientific experience, extant throughout the preceding treaties, was even more explicitly asserted in the subsequent ones.”

In Canada: June 9 1977 *Cruickshank* (Article 18) Gibson J. held that the Pensions Article (1) in the 1951 France tax treaty covered lump sum pensions. He considered it relevant that non-periodic (i.e. lump-sum) pensions were subsequently covered explicitly by the Pensions Article of the 1975 France tax treaty – even though this Article switched the right to tax pensions to the source State from the residence State.

Canada: February 13 1985 *Taran Furs* (Article 7 and see Chapters 8.09 and 29.08) involved the 1955 Denmark and 1959 Finland tax treaties. Neither treaty defined interest – and both parties referred to the last sentence in Article 11(3) of the 1977

OECD Model which provides: “Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.”

Revenue Canada argued that the 1977 OECD Model specifically excluded penalty charges from the definition of interest because they were implicitly included in the ordinary definition of interest. *Taran Furs* argued the opposite: this exclusion indicated that, in a tax treaty context, “interest” only meant pure borrower-lender interest and did not include penalty charges for late payment of goods.

Tremblay J. did not discuss these arguments – because *Taran Furs* won its case on different grounds. However, he could usefully have referred to the first sentence of Para. 20 of Commentary on Article 11 of the 1977 OECD Model which runs in part: “... Contracting States are free to omit this sentence and treat penalty charges as interest in their bilateral conventions.” This clarifies that Article 11(3)’s last sentence is optional. Revenue Canada made this point – arguing that this last sentence’s omission from the subsequent 1978 UK tax treaty confirmed its optional nature.

Canada: September 7 1979 *Hunter Douglas* (Article 10) illustrates the importance of the evolution of tax treaty terms. It involved Article 4(5) of the 1957 Netherlands tax treaty, which provided that State A could not impose tax on dividends paid to a non-resident of State A (even a resident of a third State) by a company resident in State B – *by reason of the fact that* these dividends represented profits derived from State A.

Hunter Douglas explained that these italicised words had originated in Article 8(3) of the 1946 London Draft – see Chapter 23.03. It noted that these words had then also appeared in Canada’s older tax treaties with New Zealand (1948), Sweden (1951), Denmark (1955), Finland (1959), Ireland (1966) and the UK (also 1966).

Subsequent versions of the 1946 London Draft (namely the 1963 OECD Draft and the 1977 OECD Model) had substituted the words “even if” for the words “by reason of the fact that” in their analogous Article 10(5). However, the various Commentaries on these subsequent versions had never given any indication that this different language was intended to achieve a different allocation of the right to tax.

This more modern language “even if” had also been used in Canada’s more modern tax treaties with Indonesia, Romania, Korea, Italy, Austria, Liberia, Spain, Malaysia, Switzerland, Dominican Republic, Philippines, Singapore, Morocco, Pakistan, Israel, Belgium, Jamaica (1978 revision), Trinidad & Tobago, Norway, Germany (1976 revision), France and the UK (1979 treaty).

Hunter Douglas argued that, as regards a tax treaty based on an OECD Model, the earlier words “by reason of the fact that” should be construed as having the same meaning as the later words “even if”. Accordingly, the words “by reason of the fact that” in the 1957 Netherlands tax treaty should be construed as meaning “even if” – the words used in Article 10(5) of the 1977 OECD Model and in Canada’s more modern tax treaties. It also argued that this interpretation was confirmed by the history of the 1942 US tax treaty.

Hunter Douglas’ arguments were supported by evidence from Mr. Martin, an officer of the Canadian Department of National Revenue, who had taken part in negotiations

on a number of later Canadian treaties, and who had advised on their application. In pre-trial examination his convincing evidence was that the words “by reason of the fact that” had the same meaning as the words “even if” – and that the change of wording did not indicate any change of treaty negotiating policy. Such an apparently incidental change of wording could hardly be presumed to result in a fundamentally different interpretation of an otherwise unchanged provision.

Hunter Douglas also produced evidence from an expert witness from the Netherlands (whose evidence was confirmed by the Netherlands Secretary of State for Finances).

Hunter Douglas’ arguments on these points were successful. However, Netherlands: *January 30 1990 The Hague GH* then came to an opposite conclusion – perhaps because it did not consider *Hunter Douglas* (or *The International Tax Treaties Service*). The Gerechtshof came to its incorrect conclusion even though a provision comparable to Article 10(5) of the 1963 OECD Draft (and the 1977 OECD Model) in the 1969 Ireland tax treaty at issue *did* contain the later OECD words “even if” (which *Hunter Douglas* had held were so clear that they clarified the meaning of the words used in the earlier treaties referred to above).

The International Tax Treaties Service then commented that an appeal against this Gerechtshof decision was likely to be successful – and so it has proved. Netherlands: *September 2 1992 HR* (Article 10) reversed *January 30 1990 The Hague GH*. It found the 1963 OECD Commentary to be most relevant in confirming that the provision comparable to Article 10(5) of the 1963 OECD Draft did preclude State A from levying withholding tax on dividends paid by a company resident in State B to any persons not resident in State A – even residents of third States. (Interestingly, Germany: *January 20 1993 BFH* (Article 7) also cited this Article 10(5) to justify its holding that Article XIV(2) of the 1954 tax treaty precluded the extraterritorial taxation of interest – see Chapter 26.02.)

France: *November 12 1992 Paris CAA* (Article 7) inaccurately holds that the definition of dividends in the 1975 Canada tax treaty is identical to that in “the” [*sic*] OECD Model – in the light of which it interpreted this 1975 treaty. In fact, this definition is not identical – though it is very similar – to that in Article 10(3) of either the 1963 OECD Draft or the 1977 OECD Model.

In France: *December 21 1990 CC* (Article 24) Conseiller Lemontey noted that although the 1966 Switzerland tax treaty did not clearly indicate that fiscal residence was a factor to be taken into account in determining whether taxpayers “in the same circumstances” were being discriminated against, the wording in the later 1967 US and 1985 USSR tax treaties might so indicate.

Germany: July 30 1990 Federal Ruling (Article 15 and see Chapter 20.05) was only issued after the German tax authorities consulted with the OECD. It cites the English text of Article 15 of the 1977 OECD Model as support for its holding that *May 10 1989 BFH* (Article 15), which involves the 1959 Netherlands tax treaty, is not to be applied.

In Netherlands: *June 24 1981 HR* (Article 14 and see Chapter 26.12) the Attorney-General dismissed the taxpayer’s argument that, under the 1973 Israel tax treaty, he

could only have a fixed base in the Netherlands if he was there for more than 183 days in a year. He referred to the 1977 Morocco and 1978 Korea tax treaties as well as the 1972 Belgium/*Israel* tax treaty. These treaties made it clear that taxability could arise if an individual resident in one Contracting State *either* had a fixed base in the other Contracting State *or* spent more than 183 days in a year in that State.

In line with *Canada: June 9 1977 Cruickshank* (see above), *Netherlands: March 26 1984 The Hague GH* (Article 18) holds that the Pensions Article in the 1973 France tax treaty covers a lump sum pension commutation. The *Gerechtshof* was particularly influenced by the Pensions Article 18 in the 1980 UK tax treaty – which, in common with the 1967 UK treaty, covers pension(s) *and* other similar remuneration *and* any annuity (italics added). The *Gerechtshof* felt that because an annuity would normally be “other similar remuneration”, such “remuneration” had to cover non-periodic payments – including lump sum payments in lieu of pension rights.

The *Gerechtshof* noted that Article 18(2) of the 1980 UK tax treaty specifically excludes lump sum payments from the definition of pensions taxable only in the residence State – and thus permits the source State to tax them. It also noted that the Explanatory Memorandum by the Netherlands Minister of Foreign Affairs on this Article 18(2) commented: “... lump sum settlements may in future be taxed in the source State.”. The need for this new specific exclusion in the 1980 UK treaty confirmed the position under the 1967 UK treaty – and, hence, the 1973 France treaty.

Netherlands: May 13 1987 HR (Article 18) came to a comparable conclusion in relation to the 1970 Finland tax treaty. It held that more recent Netherlands tax treaties, such as those with Greece and the UK, supported to its conclusion.

March 26 1984 The Hague GH and *May 13 1987 HR* (and other decisions) were acquiesced to in *Netherlands: November 2 1987 Ruling* (Article 18) – which extended their application to 21 different tax treaties with the same words (see Chapter 24.07).

In *South Africa: March 10 1992 ITC 1544* (Article 24) Melamet J. found it most instructive to compare (1992 SATC 463) the 1971 Netherlands tax treaty with earlier and subsequent tax treaties – see Chapter 23.21.

In *UK: May 19 1989 Padmore* (Article 3) Counsel for both sides referred extensively to other tax treaties and their history in presenting their arguments as to the meaning of the 1952 Jersey Tax Arrangement (treaty) – see Chapter 23.21.

In the High Court, Peter Gibson J. specifically referred to the 1955 Switzerland tax treaty to illustrate why he rejected a Revenue argument as to the meaning of the 1952 Jersey tax treaty. He commented (62 T.C. 371C) that this argument involved: “... writing in words which cannot be said to be plainly implicit in para 3(2). What is needed is extra wording such as that found in Article II(3) of the 1955 Double Taxation Arrangement with Switzerland that such provision is in the case of a partnership not to be construed as restricting the right of the UK to charge any UK resident partner to tax on his share of the income of the partnership.”

However, in the Court of Appeal, Fox L.J. did not find references to other (unnamed) treaties to be of assistance – see Chapter 23.21. He held (62 T.C. 377): “Reference to

the provisions of other Double Taxation Arrangements are not, in my view, of assistance. We are construing this particular Arrangement. Other countries may have negotiated different bargains.”

US: Rev. Rul. 86-156 (Article 7) used the 1981 US Model as an aid in interpreting of the much earlier 1948/65 Netherlands tax treaties.

US: Notice 87-66 (Article 24) notes that Article 24(5) of the 1981 US Model is identical to Article 24(6) of the 1977 OECD Model.

US courts have also referred to later tax treaties on several occasions, as the following examples show. July 22 1966 *London Displays* (Article 12) considered the 1949 Norway and 1953 Australia tax treaties in interpreting the 1948 Netherlands Antilles tax treaty. May 27 1980 *Riley* (Article 14) involved the 1942 Canada tax treaty – but Tannenwald J. considered later tax treaties with Japan (1954 and 1971, which he compared), Finland (1970), Iceland (1975), Switzerland (1951) and Denmark (1948). August 25 1982 *Brown & Williamson* (Article 29) involved the 1975 UK *income* tax treaty – but, as indicated in Chapter 26.03, an earlier and revoked (1945) estate tax treaty with the UK was considered, as were later (1978) estate tax treaties with France and the UK. August 26 1985 *Crow* (Article 1 and see Chapter 28.18) involved the 1942 Canada tax treaty, but Cohen J. cited several other tax treaties and considered the 1980 (successor) Canada tax treaty, the (unusual) 1980 Malta tax treaty and the 1977 US Model.

26.02 Other subsequent tax treaties or Models may not elucidate earlier tax treaties

When a tax treaty does not contain a point covered by subsequent tax treaties, it should not necessarily be interpreted as being as broad as these later tax treaties.

In Australia: August 7 1990 *Case X69* (Article 3) the taxpayer unsuccessfully argued that the 1953 US tax treaty should be interpreted as if it contained provisions in the 1967 UK and 1972 New Zealand tax treaties. Dr. Y.F.R. Grbich held (90 ATC 536): “20. ... to assert that one treaty between sovereign nations lays down a requirement expressly is not a very strong basis for inferring that another treaty, which leaves such matters silent, means to exclude them. Treaties are negotiated by the revenue authorities at arm’s length and we can assume a high degree of consciousness about what they say and what they do not. Silence is very often a deliberate decision which does not admit an inference about what was left out.”

Germany: *October 9 1985 BFH* (Article 7 and Chapter 6.05) found it relevant that Article VII of the 1954 US tax treaty did not contain provisions or exceptions which would cause Article VII(3) to overrule Article XIV(2), as later US tax treaties (such as the 1970 US/Belgium tax treaty) did. It held that this omission meant that Article VII(3) did not overrule Article XIV(2).

However, *January 20 1993 BFH* (also Article 7 and see Chapter 6.05) found that the only purpose (see Chapter 11.03) of Article XIV(2) was to preclude the extraterritorial taxation of (dividends and) interest – in the same way as Article 10(5) of the 1977 OECD Model sought to preclude the extraterritorial taxation of dividends (only), as

explained in Chapter 26.01. *January 20 1993 BFH* conflicts squarely with *October 9 1985 BFH*.

26.03 Omissions in subsequent tax treaties may be significant

If earlier tax treaties exclude a particular remedy, the fact that a subsequent tax treaty (notably a successor treaty) does not also exclude this remedy may indicate that it is available.

In US: August 25 1982 *Brown & Williamson* (Article 29 and see Chapters 12.04 and 23.21), involving the 1975 UK *income* tax treaty, the taxpayer sought interest on late refunds of tax – an issue this treaty did not explicitly cover. Expressing the majority view, Chief Judge Friedman considered it relevant that (688 F.2d 751): “There have been other tax treaties that expressly provided that refunds were to be made without interest. Convention on Estate, Inheritance and Gift Taxes, Nov. 24, 1978, US-France, ... ; Convention on Estate Taxes, April 16, 1945, US-UK, ... *revoked* ... When the draftsmen of treaties intended to deny interest, they knew how to do so.”

However (the dissenting) Senior Judge Skelton commented (688 F.2d 762): “The majority stresses the fact that there have been other tax treaties which provided that refunds were to be made without interest, pointing to a treaty with France and another with the UK, but the Treaty involved here has no such provision. It is not clear why the other treaties are mentioned, since each must stand on its own feet, unless by doing so the majority infers that since the Treaty before us does not mention interest on the tax refund while some other treaties prohibit it, there is thereby created *by implication* an obligation on the government to pay interest. If that is the purpose of the discussion about other treaties as compared to the one here, the majority runs squarely afoul of the many cases that hold that liability for interest cannot be imposed on the government by implication.” After citing authority, he concluded (688 F.2d 762): “Therefore, the comparison of other treaties with the one before us does not impose by implication any obligation on the government to pay interest in this case, and is wholly irrelevant.”

26.04 Can subsequent OECD Commentary be invoked at a public international level?

The issue of whether subsequent OECD Commentary can be used to interpret substantially identical terms in earlier tax treaties must be viewed, once again, at both a public international level and a domestic level.

When a tax treaty pre-dates OECD Commentary, the treaty partner States could not have been aware of the contents of this future Commentary when they negotiated this tax treaty. However, *as between themselves*, they can agree to use later Commentary to interpret earlier tax treaties.

As Chapter 16.01 makes clear, Article 31(3)(a) of the Vienna Convention requires account to be taken of any subsequent agreements between States – because States can, as between themselves, agree to anything.

It is arguable that OECD Member States have already agreed to use later OECD Commentary to interpret earlier tax treaties – in line with the OECD Committee on

Fiscal Affairs' conclusions to this effect.

Para. 30 of this Committee's Introduction to the 1977 OECD Model runs: "30. The Committee on Fiscal Affairs has examined the problem of conflicts of interpretation which could arise as a result of changes in the text of the Articles or of the Commentaries. The Committee considers that existing conventions should, as far as possible, be interpreted in the spirit of the new Commentaries, even though the provisions of existing conventions do not yet contain the more precise wording of the 1977 Model Convention. Member countries wishing to clarify their positions in this respect can do so by means of an exchange of letters between competent authorities in accordance with the mutual agreement procedure. Even in the absence of such an exchange of letters, these authorities could use mutual agreement procedures to secure this interpretation for particular cases."

Para. 33 of the Introduction to the (1992) OECD Model notes the above, and Para. 34 following then comments: "34. This position still reflects the views of the Committee and is therefore applicable to changes to the Articles of the Model Convention or the Commentaries that have been made since 1977."

At a public international level, this approach could generally apply as between OECD Member States themselves – subject to two facts. Firstly, in the 1977 OECD Model several Member States amended their Reservations to the 1963 OECD Draft, whilst others made Reservations and Observations for the first time. The (1992) OECD Model, and its 1994 Update, contain comparable deviations from the 1977 OECD Model. Secondly, OECD and UN materials accept that even existing Commentaries which pre-date a tax treaty do not constitute legal binding agreements or instruments – see Chapters 23.16 and 23.24; subsequent Commentaries can only have a lesser status.

There are obvious attractions in using later (1977 and 1992+) OECD Commentary as a means of interpreting tax treaties modelled on an earlier (1963) OECD Draft or (1977) Model – and good reasons for doing so.

Firstly, both the 1977 and 1992 OECD Models follow the broad outline of the 1963 OECD Draft, leaving its basic structure of 30 Articles unchanged. When an Article and its Commentary both remain unchanged, there must be a presumption that OECD Member States consider this Article to be appropriate, and that the Commentary accurately reflects their intentions as to its meaning.

Secondly, many of the 1977 and 1992 changes are minor. When these changes reflect a desire to clarify the text's meaning in the light of experience, rather than to introduce any new principles, it may be appropriate to consider later OECD Commentary – even in relation to an earlier tax treaty. The weight to be given to later Commentary will depend partly on the extent of the changes it makes – the less substantial the changes, the greater the weight.

However, some Articles and Commentaries in the 1977 and 1992 OECD Models do make considerable changes to their earlier OECD analogues. A September 20 1977 OECD News Release commented that the 1977 changes aim "both to give additional protection to taxpayers against the possibility of double taxation and to facilitate the

task of national administrations in combating tax avoidance and evasion.” This comment may understate the extent of the changes made in 1977, notably as regards exchange of information – see Chapter 26.06.

Para. 35 of the Introduction to the (1992) OECD Model confirms that when the text of an Article (or its Commentary) is substantially changed, later Commentary will be of little or no relevance in interpreting earlier Articles – even at a public international level, and certainly at a domestic level. Paras. 35 and 36 run: “35. Needless to say, amendments to the Articles of the Model Convention and changes to the Commentaries that are strictly consequential to these amendments will not be relevant to the interpretation or application of previously concluded conventions where the provisions of these conventions are different in substance from the amended Articles. However, other changes or additions to the Commentaries should normally be applicable to the interpretation and application of the conventions concluded before their adoption as they reflect the consensus of the OECD Member countries as to the proper interpretation of existing provisions or as to their application to specific situations.

36. Whilst the Committee considers that changes to the Commentaries should be relevant in interpreting and applying conventions concluded before the adoption of these changes, it disagrees with any form of *a contrario* interpretation consisting in inferring from a change to an Article of the Model Convention or to the Commentaries that the previous wording of that Article or the Commentaries implied different consequences from those that result from the modified wording of the Article or the Commentaries. As many amendments are intended to simply clarify, not change, the meaning of the Articles or the Commentaries, such *a contrario* interpretations would clearly be wrong in many cases.”

These Paras. should be considered in the light of the comments Chapters 26.05-26.11 – and the Committee’s wish to revise the looseleaf OECD Model on an on-going basis so as to reflect the *current* views of OECD Members (see Chapter 23.13).

26.05 Can subsequent OECD Commentary be invoked at a domestic level?

At a domestic level, considerations apply which differ fundamentally from those applicable at a public international level.

This statement is made despite the fact that Resolution 1(c) on Subject I *Interpretation of double taxation conventions* at the 1993 IFA Congress provides that (all) OECD and UN Commentaries “should be accorded considerable weight in dealing with conventions that conform to these Models”. This wording, the result of an amendment (by a very small margin) to the Resolution proposed by the Panel (of which I was a Member), does not distinguish sufficiently between the different weight which should be given to Commentary which precedes, and Commentary which postdates, a tax treaty. Had more time been available, Resolution 1(c) could no doubt have been amended to address this issue of relative weight – and such an amended Resolution would probably have been carried by a substantial majority.

This statement is also made despite Netherlands: *July 4 1989 HR* (Article 18 and see

Chapter 26.12) which has approved of the application, at a domestic level, of Para. 30 (cited in Chapter 26.04) of the Introduction to the 1977 OECD Model.

Para. 30's suggestion that "existing conventions should, so far as possible, be interpreted in the spirit of the new Commentaries" disturbs me (and others – see Langer 1978, 757 and 758) for two reasons.

Firstly, particular caution should be exercised in applying revised or new Commentaries which post-dates a tax treaty. This reflects the (third) principle governing the weight which should be given to supplementary means of interpretation: more weight should be given to existing or contemporaneous material than to subsequent material – see Chapter 21.05. By definition, subsequent material cannot have been in the mind of both parties when they originally negotiated a tax treaty.

The implementation of the suggestion in Para. 30 effectively amounts to the creation of retroactive negotiating history – a contradiction in terms. The risk of this contradiction being ignored is particularly disturbing in a tax treaty context – because of the second reason why caution should be exercised in applying new or revised Commentaries which post-date a tax treaty.

26.06 Self-serving OECD Commentary; the exchange of information

The second reason why less weight should be given to subsequent Commentaries on existing tax treaty terms than to earlier Commentaries (in the light of which later tax treaties may have been negotiated) is that OECD Commentaries may be self-serving. The OECD is an organisation composed entirely of Member States; taxpayers are not represented. Furthermore, the OECD Committee on Fiscal Affairs has always been composed of governmental officials, generally those specialising in tax treaties. Accordingly, OECD tax treaty material is essentially drafted by States – without little (if any) input from taxpayers. Needless to say, States' views as to the meaning of a tax treaty term may conflict with taxpayers' views. Tax-levying Member States have a clear interest in having the OECD promote their own views – and it would be unrealistic to expect the OECD to do otherwise. Revisions to OECD Commentaries may thus represent wishful thinking on the part of their drafters – who may have the interests of (their) States, and not taxpayers, at heart.

The risk of domestic courts basing themselves upon self-serving retroactive negotiating history is particularly high as regards exchange of information Articles (and their Commentaries). This material has been considerably broadened every time it has been revised – always in favour of tax authorities.

Para. 4 of the Commentary on the 1977 OECD Model's Article 26 (which incorporates the 1974 provisional revisions to the 1963 OECD Draft and Commentary) runs (*italics added*): "4. Experience in recent years has shown that the text of the Article in the 1963 Draft Convention left room for differing interpretations. Therefore it was felt desirable to clarify its meaning by a change in the wording of the Article and its Commentary *without altering its effects*. Apart from a single point of substance (*cf.* paragraph 13 below) the main purpose of the changes made has been to remove

grounds for divergent interpretations.”

The above italicised words are, arguably, misleading, because the considerable 1977 changes (based on the 1974 provisional revisions) to the text and Commentary of Article 26 have altered its scope – unsurprisingly, to the advantage of tax authorities.

A further factor is that some Member States (such as the US) can have a greater influence in the OECD than others – so their views may be increasingly well reflected in OECD Commentaries.

Curiously, the 1992 ALI Report does not even consider the risk that courts may give weight to self-serving retroactive negotiating history – even though this risk may be higher in the US than elsewhere. For example, US: October 22 1975 *Burbank* (Article 26 and see Chapter 13.03) illustrates how the US cited subsequent (provisional) Commentaries to its advantage – and to the disadvantage of a taxpayer.

Burbank involved the Exchange of Information Article in the 1942 Canada tax treaty. On July 31 1974 the US District Court, Southern District of New York, held that the IRS could not properly utilise its summons authority. *Subsequently*, the 1974 Commentary on the OECD 1974 provisional Revised Draft of Article 26 broadened Article 26’s scope in favour of tax authorities. Mulligan J. considered not only the 1963 OECD Draft but also the provisional 1974 revisions to the Commentary – and reversed the District Court. Of particular concern is that these 1974 revisions had been drafted largely at the initiative of the US – which, as the appellant in *Burbank*, was arguing that they should apply to a 1942 tax treaty.

Seemingly oblivious to the possibility of self-serving retroactive negotiating history, Mulligan J. commented (525 F.2d 16 and 17, footnotes omitted): “... the new Commentary reinforces the Government’s position, which we have adopted here, that American administrative procedures (which include the administrative summonses in issue here) are properly utilized where the purpose is solely to assist the investigation of a Canadian potential tax liability.”

Burbank was cited in US: February 14 1980 *Lincoln First Bank* (Article 26) when Pierce J. also considered the OECD 1975 [*sic*] provisional revised Commentary upon which, he incorrectly noted (80-1 USTC 83,405), the 1971 Norway tax treaty was “apparently patterned” – see Chapter 13.02.

26.07 *Self-serving OECD Commentary; the “improper” use of tax treaties*

Para. 7 of the Commentary on Article 1 of the 1977 OECD Model ran in part: “... taxpayers have the possibility, double taxation conventions being left aside, to exploit the differences in tax levels as between States and the tax advantages provided by various countries’ taxation laws, but it is for the States concerned to adopt provisions in their domestic laws to counter possible manoeuvres. Such States will then wish, in their bilateral double taxation conventions, to preserve the application of provisions of this kind contained in their domestic laws.”

Para. 7 effectively concluded that all anti-avoidance provisions have to be specifically “preserved” or confirmed in a tax treaty. However, Para. 7 does not appear

(anywhere) in the (1992) OECD Model. Quite the reverse. Among the many new Paras. dealing with the “improper use” of tax treaties, Para. 24 of the Commentary on the (unchanged) Article 1 of the (1992) OECD Model runs in part (*italics added*): “The main problem seems to be whether or not general principles such as “substance-over-form” are inherent in treaty provisions, i.e. whether they can be applied in any case, or only to the extent they are expressly mentioned in bilateral conventions. ... it is the view of the wide majority that *such rules*, and the underlying principles, *do not have to be confirmed in the text of the convention* to be applicable.”

Although it could be argued that Para. 7 of the 1977 OECD Commentary only referred to specific anti-avoidance provisions, and that Para. 24 of the 1992 OECD Commentary only refers to general anti-avoidance principles, this 1992 Commentary (foreshadowed in the 1987 OECD *Conduit Companies* Report – see Chapter 23.10) seems to favour tax authorities to a greater extent than the 1977 Commentary.

26.08 *Self-serving OECD Commentary; employers*

Para. 8 of the Commentary on the 1992 OECD Model’s Article 15(2)(b) (unchanged from the 1977 OECD Model) now gives wholly new definitions of an employer which follow those suggested in the 1985 OECD *Hiring-out of Labour* Report – see Chapter 23.10. Para. 8 also contains a significant new comment: “In this context, substance should prevail over form ...”.

26.09 *Self-serving OECD Commentary; artistes and sportsmen*

As foreshadowed in the 1974 provisional Revised Draft, the 1977 OECD Model includes a new Article 17(2) which runs (*italics added*): “Where income in respect of personal activities exercised by an entertainer or an athlete in his capacity as such accrues not to the entertainer or athlete himself but to *another person*, that income may, notwithstanding the provisions of Articles 7, 14 and 15, be taxed in the Contracting State in which the activities of the entertainer or athlete are exercised.” Apart from substituting the words “(a) sportsman” (*sic*) for “(an) athlete” (see Chapter 9.03), Article 17(2) of the (1992) OECD Model is identical to its 1977 predecessor.

Para. 4 of the 1977 OECD Commentary on Article 17(2) of the 1977 OECD Model began (*italics added*): “The purpose of paragraph 2 is to counteract *certain tax avoidance devices* in cases where remuneration for the performance of an entertainer or athlete is not paid to the entertainer or athlete himself but to another person, e.g. a so-called *artiste-company*, in such a way that the income is taxed in the State where the activity is performed neither as personal service income to the entertainer or athlete nor as profits of the enterprise in the absence of a permanent establishment. *Paragraph 2 permits the State* in which the performance is given *to impose a tax on the profits diverted* from the income of the entertainer or athlete to the enterprise *where for instance the entertainer or athlete has control over or rights to the income thus diverted or has obtained or will obtain some benefit directly or indirectly from that income*. It may be, however, that the domestic laws of some States do not enable them

to apply such a provision. Such States are free to agree to alternative solutions or to leave paragraph 2 out of their bilateral convention.”

However, Para. 11 of the 1992 OECD Commentary on this virtually unchanged Article 17(2) now runs in part: “... Paragraph 2 deals with situations where income from their activities accrues to other persons. If the income of an entertainer or sportsman accrues to another person, and the State of source does not have the statutory right to look through the person receiving the income to tax it as income of the performer, paragraph 2 provides that the portion of the income which cannot be taxed in the hands of the performer may be taxed in the hands of the person receiving the remuneration. If the person receiving the income is an enterprise, tax may be applied by the source country even if the income is not attributable to a permanent establishment there. If the person receiving the income is an individual, the income may be taxed even in the absence of a fixed base. But it will not always be so. There are three main situations of this kind.

a) The first is the management company which receives income for the appearance of e.g. a group of sportsmen (which is not itself constituted as a legal entity).

b) The second is the team, troupe, orchestra, etc. which is constituted as a legal entity. Income for performances may be paid to the entity. Individual members of the team, orchestra, etc. will be liable to tax under paragraph 1, in the State in which a performance is given, on any remuneration (or income accruing for their benefit) as a counterpart to the performance. The profit element accruing from a performance to the legal entity would be liable to tax under paragraph 2.

c) The third situation involves certain tax avoidance devices in cases where remuneration for the performance of an artiste or sportsman is not paid to the artiste or sportsman himself but to another person, e.g. a so-called artiste company. ...”

The application of Article 17(2) to situations covered by c) corresponds to the position under the 1977 OECD Model – but the 1992 OECD Commentary on situations covered by a) and b) does not contain any of the 1977 OECD Commentary’s requirements, in its examples, that an entertainer or athlete must have “control over” or “rights to”, or must obtain “some benefit” from, “diverted” income. Arguably, the 1992 OECD Commentary seeks to substantially widen the scope of the essentially unchanged Article 17(2) to cover situations where no tax avoidance motives may exist.

26.10 *Self-serving OECD Commentary; non-discrimination and transfer pricing*

In recent years, as part of its focus on inter-company pricing, the US has imposed more onerous reporting requirements on non-residents doing business in the US. These requirements have been attacked as being discriminatory – as they may be. In this context, the addition of Para. 59 to the Commentary on the (1992) OECD Model’s Article 24(5) (which is identical to its 1977 version) seems self-serving.

Para. 59 runs: “In the case of transfer pricing enquiries, almost all Member countries consider that additional information requirements which would be more stringent than the normal requirements, or even a reversal of the burden of proof, would not

constitute discrimination within the meaning of the Article.”

26.11 *The use of subsequent OECD Commentary in Germany and Switzerland*

Only in Germany and Switzerland have domestic courts focused sufficiently on the inappropriateness of using later OECD Commentaries to interpret earlier tax treaties.

Germany: *August 9 1985 Hamburg FG* (Article 24) holds that the 1974/1977 OECD Commentaries could not apply to the earlier 1966 Japan tax treaty – and that, even if they could, they did not support the argument of the party invoking them.

In Germany: *January 20 1988 BFH* (Article 26) the issue was whether information could be exchanged spontaneously under the 1959 France tax treaty. Article 26 of the 1963 OECD Draft only provided for exchanges of information on application – and not spontaneously. Subsequently, both the 1974 OECD Revised Draft and Para. 9 of the Commentary on Article 26 of the 1977 OECD Model permitted spontaneous exchanges. Because the 1959 France tax treaty pre-dated the first appearance in OECD materials of provisions permitting spontaneous exchanges of information, it was argued that information could only be exchanged on request.

The BFH felt it unnecessary to decide this argument – because it held that spontaneous exchanges of information were permissible under German domestic legislation (s.2(2)(1) EGAHiG). This legislation gave the December 19 1977 EEC Directive on Mutual Assistance by the Competent Authorities of Member States in the Field of Direct Taxation (and its December 6 1979 VAT analogue) force of law in Germany. s.1(3) EGAHiG confirmed that s.2(2)(1) EGAHiG was to prevail over any narrower tax treaty text.

In Germany: *April 29 1992 BFH* (Article 26) the taxpayer argued that information relating to 1981 could only be exchanged pursuant to this 1954 US tax treaty – which did not permit the spontaneous exchange of information. The BFH held that Article XVI(1) of this 1954 treaty permitted information to be exchanged spontaneously – as Article 26 of its 1989 successor also clearly did. Accordingly, it did not have to decide which treaty governed.

The BFH rejected the argument (in Vogel – 1990, 1366 *et seq.*) that, because the spontaneous exchange of information had first been referred to by Para. 9 of the 1977 OECD Commentary on Article 26, the 1954 tax treaty did not permit spontaneous exchanges. s.117(2) AO (Fiscal Code) allowed any exchanges of information which were permitted by a tax treaty, and this 1954 US treaty permitted any exchanges of information involving “the prevention of fraud” – including spontaneous exchanges.

Switzerland: *May 18 1988 Geneva TA* (Article 5) holds that 1977 OECD Commentary could be used to interpret the 1966 France tax treaty – because all Swiss tax treaties since 1963 have followed the 1963 OECD Draft and the 1977 OECD Model.

However, Switzerland: *June 22 1990 Bundesgericht I I* (Article 15) holds that the 1951 US tax treaty could not have been modelled on the 1977 OECD Model – or on its earlier 1963 OECD Draft (as the 1971 Germany tax treaty had been). Accordingly,

neither the bilateral Swiss/German Commentaries on this 1971 Germany treaty (see Chapter 27.28), nor the OECD Commentary on the 1977 OECD Model, could influence the interpretation of this 1951 US treaty – despite the Swiss tax authorities' arguments to the contrary. This decision should be contrasted with Switzerland: *October 23 1987 Bundesgericht* (Article 23) – see Chapter 26.13.

26.12 Courts have often referred to subsequent OECD Commentary

Denmark: *December 18 1992 Supreme Court* (Article 7) interpreted the 1948 US tax treaty by reference to the 1977 OECD Model's Commentary (which resembled the Commentary on the 1963 OECD Draft). Furthermore, the majority seemingly interpreted Danish domestic law in the light of Article 7 of the 1977 OECD Model and, in particular, Para. 17 of its Commentary, holding: "It must be recognised that Danish and international tax practice – based on the OECD Model Conventions and their commentaries cited above – has generally accepted that interest on loans between a head office and its foreign branch cannot be deducted in determining this branch's taxable income."

In France: *May 13 1983 CE* (Article 4) *Commissaire du Gouvernement Bissara* considered that Para. 28 (presumably) of the Commentary on Article 25 of the 1977 OECD Model supported his view that a taxpayer is generally only bound by a competent authority agreement if he accepts it – see Chapter 27.07.

In France: *June 2 1986 CE* (Article 25) the *Commissaire du Gouvernement* found Paras. 13 and 25 of the Commentary on Article 25 of the 1977 OECD Model to be persuasive in relation to the 1964 Belgium tax treaty.

In Netherlands: *March 14 1979 HR* (Article 4) the Attorney-General considered Para. 15 of the Commentary on Article 14 of the 1977 OECD Model in relation to the 1971 Spain tax treaty. He also considered various foreign decisions and rulings which he had researched by using *The International Tax Treaties Service* – see Chapters 28.05 and 29.11.

Netherlands: *June 24 1981 HR* (Article 14 and see Chapter 25.02) noted that when the Finance Minister and the Under-Minister for Foreign Affairs submitted the 1973 Israel tax treaty to Parliament, they indicated that it was generally based on the 1963 OECD Draft. It therefore referred to this Draft and its Commentary, the 1977 OECD Model and its Commentary, and other tax treaties (see Chapter 26.01) in holding that a fixed base could exist even if less than 183 days were spent in the Netherlands.

Netherlands: *March 26 1984 The Hague GH* (Article 18) considered the 1977 OECD Commentary in relation to the 1973 France treaty.

Netherlands: *June 28 1989 HR/2* (Article 4) implicitly accepted the view of the Amsterdam *Gerechtshof*, and Attorney-General Van Soest, that the 1964 Netherlands Antilles tax treaty should be interpreted in the light of the 1977 OECD Model and its Commentary. In the light of this OECD material, it denied tax treaty benefits to a "sham" Antilles company.

In Netherlands: *July 4 1989 HR* (Article 18) the Amsterdam *Gerechtshof* referred to

the 1963 OECD Draft and the 1977 OECD Model and their Commentaries in interpreting the 1970 Austria tax treaty. It expressly approved of Para. 30 of the Report of the OECD Committee on Fiscal Affairs on the 1977 OECD Model (see Chapter 26.05). The Hoge Raad also considered the 1963 OECD Draft and the 1977 OECD Model, as well as Para. 2 of the Commentary on Article 18 of the 1977 OECD Model.

In Sweden: *November 19 1987 Supreme Court* (Article 24) the JCNTB cited Para. 57 of the Commentary on Article 24 of the 1977 OECD Model in interpreting the 1968 Switzerland tax treaty. Its holding was upheld by the Supreme Court.

In UK: June 12 1986 *Sun Life* (Article 7 and see Chapter 23) Vinelott J. considered the 1977 OECD Commentary in relation to terms in the 1967 Canada tax treaty which were identical in its 1980 successor. He noted (59 T.C. 313): “The Commentary is not, of course, a commentary on the 1967 Treaty which has a different origin, but the views of the experts who sat on the Fiscal Committee on the regulation of double taxation are clearly entitled to very great weight.”

26.13 Litigants have often referred to subsequent OECD Commentary

In France: June 4 1984 *Reply Bockel* (Article 12) the Minister of Finance noted that a definition of royalties in Article 13(3) of the 1966 Switzerland tax treaty was identical to that in Article 12(2) of the 1977 OECD Model. Relying upon the definition of “know-how” in the third sentence of Para. 12 of the Commentary on Article 12 of 1977 OECD Model, he concluded that sums paid for access to private knowledge were royalties.

Netherlands: *March 24 1976 HR* (Article 5) involved the 1959 Germany tax treaty. The Netherlands Under-Minister of Finance nevertheless sought to rely on Para. 13 of the Commentary on Article 5 of the 1963 OECD Draft in his unsuccessful argument that a packing shed was not a permanent establishment.

In Norway: *November 9 1992 Supreme Court* (Article 25) the Norwegian tax authorities invoked Para. 33 of the Commentary on Article 25(3) of the 1977 OECD Model in support of their argument that a competent authority agreement should be given effect – see Chapter 27.16.

In South Africa: May 25 1990 *ITC 1503* (Article 8) both parties agreed that, in interpreting which was probably the 1957 France sea and air transport tax treaty, references could be made to the 1977 OECD Model – without any admissions being made as to its evidentiary value. Melamet J. permitted this reference and cited (53 SATC 348) the 1977 OECD Commentary – even though it probably post-dated the sea and air transport tax treaty at issue by some 20 years.

In Switzerland: *October 30 1987 Bundesgericht* (Article 23) the Swiss tax authorities argued that because neither the Swiss Federal Tax Code nor the 1966 Ireland tax treaty contained provisions relating to prior foreign branch losses, this omission should be rectified by “applying” Para. 44 of the Commentary on Article 23 of the 1977 OECD Model. The Bundesgericht refused to “apply” Para. 44 in the way suggested – for the good reason that Para. 44 clearly provides that problems associated with losses should

be rectified primarily by domestic legislation (clarified, if necessary, by bilateral agreement). The Bundesgericht could also have held, as it subsequently did in *June 22 1990 Bundesgericht/1* (Article 15 and see Chapter 26.11), that later OECD Commentary could not be used to interpret an earlier tax treaty.

Avery Jones has remarked (1993, 611): “Whether later Commentaries can be used to interpret an earlier treaty has never arisen in the courts. Although the introduction to the 1977 Model states that it shall be used for interpretation, it is doubtful whether a UK court would do so on the basis that the later version was not available to treaty negotiators.” However in UK: April 12 1991 *Commerzbank* (Article 24) Nolan L.J. noted ([1991] STC 276) that counsel (for the bank) had referred to OECD Commentary (Para. 10) on Article 24 of the 1977 OECD Model “on which Article XX of the UK/FRG convention is based.” Nolan L.J. then cited Para. 10 – even though this 1964 Germany tax treaty pre-dates Para 10. Probably because Para. 10 is comparable to Para. 9 of the Commentary on the 1963 OECD Draft, but possibly on instructions, counsel for the Revenue did not question this reference to later Commentary.

GCM 39373, underlying US: LR 85-26-005 (Article 5), rejected a rationale involving the 1948 Netherlands tax treaty (and 1965 amendments) reached in US: LR 84-24-007 (Article 3) – because it was in conflict with Para. 14 of the Commentary on Article 5 of the OECD 1977 Model.

26.14 *Subsequent OECD Commentary should always be considered, if not relied upon*

The problems which can arise if OECD material is completely ignored by a court are illustrated by US: October 16 1984 *Boulez* (Article 12, also analysed in Chapter 8.19).

Under a 1969 contract, CBS Records paid the conductor Boulez \$2,000 for each of several recording sessions – a fact not included in the judgment (perhaps unsurprisingly in view of its holding) but discussed in 63 *Taxes International* 86. CBS Records also agreed to pay Boulez “royalties” linked to sales of the recordings.

Each \$2,000 was a non-refundable advance against future royalties from sales of the recordings produced at these sessions. These advances were no doubt paid (and taxed) long before the 1975 royalties at issue.

In 1975 CBS Records paid Boulez royalties from sales of these recordings. Both Germany (Boulez’s State of residence) and the US (the source State) then taxed Boulez on these 1975 royalties.

Germany taxed these sums as royalties – on which Boulez was taxable only in Germany (his State of residence). The US taxed these sums as remuneration for personal services – on which Boulez was taxable in the US (where the recording sessions took place).

Judge Körner upheld the US tax assessment on Boulez – despite the fact that this resulted in double taxation. He held (83 T.C. 591): “The [1954 Germany tax] treaty is not explicit, and we have found no cases or other authorities which would give us an interpretation of the treaty on this point. We are therefore remitted to US law for the purpose of determining this question. Treaty, *supra* at art. II(2).”

In common with Article 3(2) of the 1977 and 1992 OECD Models, Article II(2) began: “(2) In the application of the provisions of this Convention by one of the Contracting States any term not otherwise defined shall, unless the context otherwise requires, have the meaning which the term has under its own applicable laws ...”

Judge Körner’s unquestioning focus on US domestic law (see Chapter 8.19) led him to ignore, *inter alia*, Article 12 of the 1977 OECD Model and its Commentary (and prior drafts and revisions). Had he given this material some weight, he might have adopted the “mixed contracts” approach in Para. 13 of this Commentary – and avoided double taxation.

The German tax authorities had advocated the adoption of Para. 13’s “mixed contracts” approach – even though it had first appeared in 1972 provisional Revised OECD Commentary, long after the 1954 Germany tax treaty (as amended by a 1965 Protocol) had been concluded.

Para. 13 provides that its “mixed contracts” approach “could also be applied in regard to certain performances by artists and, in particular, in regard to an orchestral concert given by a conductor or a recital given by a musician. The fee for the musical performance, together with that paid for any simultaneous radio broadcasting thereof, seems to fall to be treated under Article 17. Where, whether under the same contract or under a separate one, the musical performance is recorded and the artist has stipulated that he be paid royalties on the sale or public playing of the records, then so much of the payment received by him as consists of such royalties falls to be treated under Article 12.”

Had Körner J. adopted this approach, he could have avoided double taxation. He could have held that only the non-refundable \$2,000 advances paid to Boulez for each recording session were remuneration for personal services (taxable in the US) – with the balance being royalties (taxable only in Germany).

Körner J.’s excessive focus on US domestic law, and on whether Boulez had a property right, probably also led him to ignore whether the royalties paid to Boulez were in respect of *use* (as they clearly were) and whether Article VIII of this 1954 Germany tax treaty only requires payments to be “for the *use* of, or the right to *use*” – irrespective of whether the “licensor” has copyright. That this is the correct interpretation of Royalties Articles has long been apparent – a point made even clearer by the 1992 OECD Model and the 1992 OECD *Software* Report (see Chapter 23.12).

Para. 1 of the Commentary on Article 12 of the 1963 OECD Draft, and the 1977 and 1992 OECD Models, has always stressed that royalties are income from “letting”.

Thus, a payment for software by a personal or business user will not be considered a royalty under the 1992 OECD Model – because such a payment permits virtually unlimited use. It effectively amounts to what Para. 43 of the 1992 OECD *Software* Report describes as the purchase of a product.

Similarly, as this Para. 43 makes clear, payments for the acquisition of software for commercial development or exploitation “were likely to be royalties especially if they were related to the number of products distributed” (i.e. use). This is because, as the

following Para. 44 makes clear, such payments are income from “letting”.

Again, the existence of copyright does not determine whether a payment is a royalty under Royalties Articles such as the Article VIII at issue in *Boulez* or Article 12 of the 1963 OECD Draft and its successors. Thus, even if copyright subsists, a payment for software by a business or personal user will not amount to a royalty – because it permits unlimited use. As Para. 14 of the Commentary on Article 12 of the 1992 OECD Model points out: “It is of no relevance that the software is protected by copyright or that there may be restrictions on the use to which the purchaser can put it.” As a corollary, therefore, a payment for use (letting), or a payment which varies according to use or sales, does amount to a royalty – even if no copyright subsists.

26.15 Subsequent OECD Commentary may clarify (much) earlier treaties

Later OECD Commentaries can also be of assistance in interpreting earlier tax treaties and decisions thereon. *Melford* (the leading decision on tax treaties in Canada) and *Ostime* (the leading decision on tax treaties in the UK) both illustrate this.

Canada: September 28 1982 *Melford* (Article 7) involved the issue of whether a new 1974 Canadian domestic definition of “interest” should determine the meaning of “interest” in the 1956 Germany tax treaty – see Chapter 10.08.

The Canadian tax authorities argued that because the word “interest” was undefined in this treaty (unlike the 1977 OECD Model) it should, under a provision comparable to Article 3(2) of the 1977 OECD Model, receive its current (1974) definition in domestic law. *Melford* successfully argued that this would amount to a unilateral override of the treaty – which could not have been intended.

Melford’s case would have been strengthened, however, had it referred to Para. 19 of the Commentary on Article 11 of the 1977 OECD Model. Para. 19 precludes “interest” from being defined by domestic law – and gives three cogent reasons why references to domestic law should be discouraged (see Chapter 8.12). Its second reason is that precluding references to domestic law “... ensures that conventions would be unaffected by future changes in any country’s domestic laws ...”

UK: July 16 1959 *Ostime* (Article 7 and see Chapters 9.01 and 10.02), as the leading House of Lords decision on a tax treaty, is accorded very considerable weight. However, UK: June 12 1986 *Sun Life* (also Article 7) illustrates some of the problems which can arise if *Ostime* is applied. With the benefit of decades of hindsight and subsequent OECD Models, it seems that *Ostime* was wrongly decided.

Ostime involved an Australian insurance society with a London branch. The UK Finance Act 1915 sought to determine a fair UK profit for UK branches of overseas life assurance companies – by reference to a formula. Under this formula, this profit was generally the same proportion of the company’s worldwide investment income as UK premiums bore to worldwide premiums. This formula was re-embodied in Rule 3 of the Rules applicable to Case III of Schedule D of the Income Tax Act 1918. Rule 3 was subsequently re-enacted as s.430 Income Tax Act 1952 (which, after amendment in 1969, appeared in s.316 Taxes Act 1970 and then s.445 ICTA 1988).

The House of Lords held that taxation under Rule 3 was precluded by Article III(3) of the 1946 Australia tax treaty.

Article III(3) began (*italics added*): “Where an enterprise of one of the territories is engaged in trade or business in the other territory through a permanent establishment situated therein, there shall be attributed to that permanent establishment the industrial or commercial profits which it might be expected to derive in that other territory *if it were* an independent enterprise engaged in the same or similar activities and its dealings with the enterprise of which it is a permanent establishment were dealings at arm’s length with that enterprise or an independent enterprise; and the profits so attributed shall be deemed to be income derived from sources in that other territory.”

In the House of Lords Lord Radcliffe commented (38 T.C. 517 and 518 – *italics added*): “It is not left wholly to the will of the UK taxing authorities to decide the basis on which that attribution of commercial profits is to be made. Article III(3) provides by its terms for *a basis* which in effect requires the hypothesis that the branch is an independent enterprise dealing as an independent entity at arm’s length with the head office. The profits which emerge from a calculation based on this hypothesis are to be deemed to be income derived from sources in the UK.

... The sole issue under appeal is whether the Respondent can be taxed at all on the Rule 3 basis. In my opinion it cannot be, because the world income from the investments of the life fund, which forms the first stage in the Rule 3 calculation of profits, cannot be attributed to the hypothetical independent enterprise without violating the very hypothesis which Article III(3) is designed to lay down as the basis of taxability.”

Despite Lord Radcliffe’s comment to the contrary, Article III(3) does not require a domestic taxing statute to be *based* on the hypothesis that a branch is an independent enterprise – if only because a branch, by definition, can never be an independent enterprise. Article III(3) simply provides that the amount of profits on which a branch/permanent establishment can be taxed – irrespective of the *basis* of taxability – shall be the amount which it might be expected to derive *if it were* an independent enterprise.

This view is supported by Para. 10 of the Commentary on Article 7(2) of the 1977 OECD Model (which is comparable to Article III(3)). The second sentence of Para. 10 runs in part (*italics added*):“... the profits to be attributed to a permanent establishment are those which that permanent establishment would have made if, *instead of dealing with its head office*, it had been dealing with an entirely separate enterprise ...” Para. 10 thus accepts that a branch can never be an independent enterprise.

Furthermore, Article 7(2) of the 1977 OECD Model (in common with Article III(3) of the 1946 Australia tax treaty) it does not lay down any rules as to the *basis* of taxability; it simply requires the *resulting profits* to be a correct amount. Indeed, Article 7(2) permits the use of any formula for calculating such profits – providing the correct amount *results*.

For example, Para. 13 of the Commentary on Article 7(2) of the 1977 OECD Model specifically provides that profits may be calculated “by applying an average ratio of

gross profit to the turnover of the permanent establishment and then deducting from the figure so obtained the proper amount of expenses incurred.” A formula such as Rule 3, which requires profits to be apportioned by applying a formula which takes account of premium income and investment income, would seem equally permissible – as the *Editorial* in *The International Tax Treaties Service* on UK: June 12 1986 *Sun Life* (Article 7) points out.

Finally, Article 7(4) of the 1963 OECD Draft (in common with Article 7(4) of the 1977 OECD Model) specifically permits a permanent establishment’s profits to be taxed “by such apportionment as may be customary.” All that matters is that, as Article 7(4) itself provides (*italics added*): “... the method of apportionment adopted should, however, be such that the *result* shall be an accordance with the principles in Article 7.” Such a provision did not, however, appear in the 1946 Australia tax treaty – though if it had, it would have been far easier to form a different (and correct) view as to the scope of its Article III(3).

The fact that modern tax treaties contain provisions comparable to Article 7(4) does not necessarily mean that, when a tax treaty does not contain such a provision, profits cannot be determined by reference to an apportionary formula. Arguably, Article 7(2) has always implicitly permitted apportionment by reference to, say, a formula; Article 7(4) has now simply made this possibility explicit.

26.16 *The importance of OECD Reports*

OECD Reports issued by the Committee on Fiscal Affairs (see Chapter 23.10 and 23.12) are essentially discussion documents – which often reveal the thinking behind (possible modifications to) the current OECD Model. Such Reports have often been cited – typically in relation to tax treaties signed long before these Reports were published.

The most frequently cited OECD Report is the 1979 OECD *Transfer Pricing* Report. In intercompany pricing cases, little attention is typically paid to the wording of tax treaty Associated Enterprises Articles, such as those comparable to Article 9(1) of the 1977 OECD Model. Attention typically focuses on general arm’s length intercompany pricing principles (including those in the 1979 OECD *Transfer Pricing* Report, which draw heavily on US principles – see Chapter 8.08) and on very detailed facts.

France: November 24 1987 Reply (Article 9) involving the 1959 Germany tax treaty, holds that the French and German tax authorities have an identical approach to intercompany pricing, and use the (later) 1979 OECD *Transfer Pricing* Report as a reference source.

France: *April 25 1990 Lyon CA* (Article 9) involved pricing between Fisons companies in France and Bermuda (which is not an OECD Member and, as a tax haven, has no comprehensive income tax treaties). Accordingly, the (only) relevant intercompany pricing provision was that under French domestic law, namely Article 57 CGI – originally introduced in 1948. Fisons nevertheless decided to defend its intercompany pricing under Article 57 CGI by reference to the three main pricing

methods mentioned in the 1979 OECD *Transfer Pricing* Report – and succeeded. This Report can thus have a global relevance which transcends tax treaties.

In Netherlands: June 12 1989 Ruling (Article 4) the Netherlands Under-Minister of Finance refused to grant a certificate of Netherlands residence to a company incorporated in the Netherlands, but with its place of management in the UK. Supposedly relying upon Para. 14(a) of the 1987 OECD *Conduit Companies* Report (see Chapter 23.10), he (incorrectly) interpreted the 1980 UK tax treaty.

Sweden: *October 22 1991 Supreme Court* (Article 9) involved prices paid by a Swedish corporation (Svenska Shell AB) to SIPC (a sister UK subsidiary of Shell Petroleum Ltd) in the six year period 1976-81. These prices concerned the cost of crude oil and the freight cost from the Gulf to Sweden.

Shell argued that sound business considerations (including the ability to switch ownership of oil whilst a VLCC was still at sea) dictated its use of VLCCs – which are too large to pass through the Suez Canal and which therefore have to take the (longer and more expensive) route past the Cape of Good Hope. Furthermore, unrelated parties would have entered into comparable freight arrangements.

Shell also argued that the tax authorities could only challenge the prices at which its actual freight arrangements *were* made. They could not argue that other hypothetical freight arrangements *should have been* made – because this argument was contrary to Paras. 15 and 23 of the 1979 OECD *Transfer Pricing* Report.

The last sentence of Para. 15 runs in part: “... as a general principle, tax authorities should base their search for an arm’s length price on actual transactions and should not substitute hypothetical transactions for them, thus seeming to substitute their own commercial judgement for that of the enterprise at the time when the transactions were concluded ...”

Similarly, Para. 23 starts: “In general, the approach which is adopted in this report to the adjustment of transfer prices for tax purposes is to recognise the actual transactions as the starting point for the tax assessment and not, in other than exceptional cases, to disregard them or substitute other transactions for them.”

The Fiscal Court of Appeal accepted the validity of the proposition enunciated in these Paras. 15 and 23 – but held that the freight cost for delivery from the Gulf to Gothenburg should not exceed the freight cost of using ships smaller than VLCCs, which could use the (shorter and cheaper) route via the Suez Canal.

The Supreme Court upheld all Shell’s arguments. As regards the freight costs, it approved of Paras. 15 and 23 of the 1979 OECD *Transfer Pricing* Report, rejecting the tax authorities’ attempt to substitute hypothetical arrangements. Although this Report was not binding, it could be relied upon and was not contrary to Sweden’s intercompany pricing provision (s.43(1) of the Municipal Tax Act). The Supreme Court also accepted the principle in Para. 17 of this Report which begins: “When examining the transfer prices adopted within a multinational enterprise, it is always useful to begin by analysing the functions of the various entities which are comprised in the relevant MNE [multinational enterprise].”

US tax authorities accept that OECD Reports are helpful discussion documents.

Thus, Issue 2 in US: LR 88-06-002 (Article 9), which involves all tax treaties, is whether the principles and conclusions set forth in the 1979 and 1984 OECD *Transfer Pricing Reports* are consistent with, and a reasonable interpretation of, the benefit test set forth in Treasury Regulation Section 1.482-2(b)(2).

LR 88-06-002 comments (italics added): “The OECD provides a forum in which members can work together to solve economic problems. The two subject reports are *advisory in nature* and not binding upon the members. More importantly, the two reports are *discussion documents* which point out the problems of taxation that exist due to the differences in the systems of taxation from country to country. In particular, *the 1984 report does not attempt to set forth rules that should be adopted by every member. Rather the 1984 report points out the problems and the differing views of tax authorities in various member states along with some courses of action the member states could take on a bilateral basis to alleviate these problems.* OECD 1984 Report, pp. 9-10. The reports are helpful in pointing out the different views that must be taken into account in interpreting the benefit test provided in Treas. Reg. Section 1.482-2(b)(2), but *they are not sufficiently conclusionary that they could be accepted as a reasonable interpretation of the benefit test.*”

Chapter 27 Subsequent competent authority agreements and practice

Article 31(3) of the Vienna Convention runs in part: “There shall be taken into account, together with the context:

(a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

(b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation; ...”

A distinction must be drawn between subsequent agreements between States (i.e. fully-fledged Supplementary Conventions or Protocols) and subsequent agreements between competent authorities – see Chapters 16 and 17.

This Chapter only deals with subsequent competent authority agreements and, to a lesser extent, practice.

27.01 Subsequent competent authority agreements at a public international level

As Chapter 16.01 notes, Para. 36 of the Commentary on Article 25 of the (1992) OECD Model runs: “Mutual agreements resolving general difficulties of interpretation or application are binding on administrations as long as the competent authorities do not agree to modify or rescind the mutual agreement.”

Nevertheless, a breach of such an agreement, in common with breaches of tax treaties themselves, will entail no legal sanctions in practice – except in the very unlikely event of both States agreeing to refer the matter to the International Court of Justice (see Chapter 2.01).

27.02 Taxpayers cannot require mutual agreements to be implemented

Although Para. 36 of the Commentary on Article 25 of the (1992) OECD Model confirms that “mutual agreements ... are binding on administrations”, it says nothing about the effect of such agreements on taxpayers. This omission doubtless results from the fact that taxpayers cannot require such agreements to be given effect, and cannot sue if they are breached – because they have no standing at a public international level (see Chapter 16.01). The fact that an agreement may bind treaty partner States at a public international level is thus of no assistance to taxpayers.

27.03 Subsequent competent authority agreements and practice at a domestic level

At a domestic level, similarly, taxpayers cannot compel any mutual agreement to be implemented – because, typically, it will have no domestic legal force (see below and Chapter 16.02). Furthermore, it would be anomalous for taxpayers to be able to compel a mutual agreement to be implemented when tax treaty provisions comparable to Article 24 of the 1977 and 1992 OECD Models do not require competent authorities themselves to even reach such an agreement in the first place.

Chapters 16.01 and 17.01 explain why subsequent competent authority agreements and practice must be taken into account at a public international level – and why far

less weight should be given to them at a domestic level (where, typically, they do not have the force of law).

The reason why mere agreements between competent authorities may not have the force of law is simple. When a taxpayer's tax treaty rights have arisen under an international (tax) *treaty* between States, they can only be changed by an instrument of equal or greater legal force – such as a Protocol to this treaty or, possibly, an overriding domestic statute.

Similarly, when a taxpayer's tax treaty rights have arisen under *domestic law*, they can only be changed by domestic law (such as an Act of Parliament). Because competent authority agreements are not themselves treaties, and will not have been incorporated into domestic law, domestic courts may disregard them – unless they consider that, under a provision in a tax treaty, a legislature has delegated its legislative powers to competent authorities.

The weight which should be given to subsequent competent authority agreements at a domestic level becomes clearer if three of the principles governing the weight to be given to any supplementary means of interpretation are considered – see Chapter 21.03 onwards.

The good faith principle (that a bilateral tax treaty should be interpreted in accordance with the common intention of *both* treaty partner States) will generally be satisfied by *bilateral* competent authority agreements.

The adequate publicity principle thus becomes of primary importance. No more account should be taken of an unpublicised competent authority agreement than any other governmental argument – unless a taxpayer has become aware of it and relied upon it, when he may advance an estoppel argument (see Chapters 27.29 and 28.19 onwards).

The contemporaneity principle reveals that, in contrast to the tax treaty itself, a subsequent competent authority agreement will not have been enacted into domestic law. Subsequent practice cannot, by definition, ever be enacted into domestic law.

However, a tax treaty will typically delegate powers to competent authorities to communicate and conclude agreements. The validity of any adequately publicised agreements reached pursuant to such delegated powers will depend both upon the constitutional permissibility of such delegation and upon the ostensible scope of the powers. The adjective “ostensible” is used because the permissible scope of these powers may be limited by legal and/or constitutional considerations in each State. These considerations may preclude effect being given to agreements reached pursuant to these powers.

In relation to Canada, Ward has commented (1977, 270, footnotes omitted): “Although Parliament clearly has the capacity to delegate its power to its own administrative bodies, it is doubtful that a Canadian court would feel bound by such administrative determinations, or find in the language of Article 25 [of the 1974 OECD provisional Revised Draft] the intention to so delegate. However, the implementing legislation for the Belgium, France and Israel treaties expressly authorizes the

Governor in Council by order to amend, revoke, replace or add to such treaties. Clearly, with these treaties (and, if the same form is followed, with all future treaties as they are ratified) the intention to delegate is clear, and administrative agreements as to interpretation may have the force of law if promulgated as Regulations.”

In relation to the US, Rosenbloom has observed (1980, 543): “a central question for me ... [is] ... has any power been delegated by the Congress of the US to the US competent authority to interpret a treaty in a creative way.”

Ultimately, this question boils down to whether a tax treaty can impose tax.

There are strong constitutional grounds for arguing that tax treaties cannot impose tax. For example, it is unlikely that the UK Parliament (or the US Congress) has delegated any part of its exclusive revenue-raising power to the Crown (or the US President and two-thirds of the US Senate). There are even stronger grounds for arguing that competent authorities cannot impose tax – because it is even more unlikely that the UK Parliament (or the US Congress) has delegated any part of its exclusive revenue-raising power to unelected civil servants.

27.04 *The scope of Article 25 of the OECD Models*

Article 25 of the 1977 and 1992 OECD Models seek to delegate powers to competent authorities in several areas. However, it should be noted that deviations from Article 25 are frequent – perhaps more frequent than in the case of any other OECD Article.

Firstly, Articles 25(1) and 25(2) – the *specific case* provisions – authorise competent authorities to resolve specific cases of double taxation referred to them. It has long been accepted that such specific case agreements do not have the force of law – see Chapter 27.09. Comparable to such specific cases are dual residence cases, where tax authorities can determine a sole State of residence – see Chapter 27.07.

Secondly, Article 25(3)’s first sentence – the *interpretative* provision – runs (italics added): “The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the *interpretation or application* of the Convention.”

Thirdly, Article 25(3)’s second sentence – the *legislative* provision – runs (italics added): “They [the competent authorities] may also *consult* together for the elimination of double taxation in cases *not provided for in the Convention*.”

Fourthly, Article 25(4) – the *communication* provision – authorises competent authorities to communicate with each other. Because this provision primarily concerns specific cases (agreements on which have long been accepted as not having the force of law) it is not discussed in detail in this Chapter.

27.05 *The scope of Article 3(2) of the OECD Models and the 1981 US Model*

Article 25 must also be considered in conjunction with Article 3 of the 1977 and 1992 OECD Models and of the 1981 US Model.

As regards terms which *are* defined in a tax treaty, such definitions will typically preclude any competent authority interpretation to the contrary.

As regards terms which are *not* defined in a tax treaty, Article 3(2) of the 1977 and 1992 OECD Models provides in part: "... any term not defined therein shall, unless the context otherwise requires, have the meaning which it has under the law of that State concerning the taxes to which the Convention applies."

Arguably (see the 1992 ALI Report 50 and 51) Article 3(2) of the 1977 and 1992 OECD Models limits competent authorities' powers to agree on the interpretation of undefined treaty terms to cases where the context requires that domestic definitions not apply. A comparable limitation may also apply to incompletely or ambiguously defined tax treaty terms – which, because they are "not defined therein", may also fall within Article 3(2).

If the words "the context" are defined broadly, as recommended in Chapters 7 and 10, this limitation will be very restrictive – because one can hardly imagine a court giving preference to a competent authority interpretation rather than a meaning required by the context.

However, this limitation may conflict with Para. 31 of the Commentary on Article 25(2) of the 1977 OECD Model which (in words which also appear in Para. 34 of the 1992 Commentary – see Chapter 27.10) provides: "... competent authorities can, in particular:– where a term has been incompletely or ambiguously defined in the Convention, complete or clarify its definition in order to obviate any difficulty; ..."

Nevertheless, if this limitation does apply to undefined, incompletely defined and ambiguously defined terms, competent authorities' powers to agree on the interpretation of tax treaty terms are therefore limited to tax treaty terms which are not defined in domestic law of the State applying the treaty *and* which have no ascertainable contextual meaning.

The issue of whether these powers are so limited becomes academic (except at the even more academic public international level) if, at a domestic level, agreements reached thereunder do not have the force of law in any event. Accordingly, it is not considered further.

In contrast, the significant difference between Article 3(2) of the 1977 and 1992 OECD Models and Article 3(2) of the 1981 US Model, discussed in Chapter 10.01, does merit further consideration.

After the words "unless the context otherwise requires" in Article 3(2) of the 1977 and 1992 OECD Models, Article 3(2) of the 1981 US Model includes the additional words "or [unless] the competent authorities agree to a common meaning pursuant to Article 25 (Mutual Agreement Procedure)" (see Chapter 7.04). These additional words do not appear in Article 3(2) of the 1979 UN Model either.

When these additional words appear in US tax treaties, their Article 25 will typically be phrased to enable competent authorities to also agree on "a common meaning of a [i.e. any] term" – (per Article 25(3)(e) of the 1981 US Model), or on "the meaning of terms not otherwise defined in this Convention" (per Article 25(3)(d) of the UK 1975 tax treaty at issue in US: March 17 1988 *Xerox* – Article 23 and see Chapter 27.18).

Baker describes these additional words in the 1981 US Model as (1991, 22 and 1994,

32) a “helpful reference” and (1991, 328 and 1994, 422) “an interesting and sensible solution”. However, it is questionable whether these additional words are helpful, or a reference, or sensible, or a solution – because the ostensible power they seek to give may, in reality, be limited by constitutional constraints.

27.06 Other bilateral competent authority provisions

Unlike the 1977 OECD Model, some tax treaties give competent authorities bilateral powers to implement a tax treaty’s provisions.

For example, Article 31 of the 1966 France/Switzerland tax treaty runs: “The competent authorities of the Contracting States shall regulate the carrying out of this Convention. They will specifically agree with respect to the refund procedure provided for in Articles 11 through 14.”

France: *June 18 1980 CE/2* (Article 11) denied treaty benefits when the French tax authorities’ procedures for obtaining these benefits had not been fulfilled. It holds that Article 31 effectively gave these procedures the force of law.

Similarly, Ad. Article 9(4) of the Final Protocol to the 1951 Netherlands/Switzerland tax treaty ran: “The supreme administrative authorities of the two States shall agree on a refund procedure and in particular on the form of application for refund, the type of supporting documents to be produced by the applicant and the measures to be taken to prevent the making of improper applications for refund.”

Pursuant to Ad. Article 9(4), a 1952 Netherlands/Switzerland Competent Authority Agreement provided that only those recipients of income who were (beneficially) entitled to such income would be able to obtain a refund of the tax withheld.

Netherlands: *May 12 1966 Amsterdam GH* (Article 4) involved a Netherlands resident owner of Netherlands securities who transferred the right to receive dividends thereon (i.e. the dividend certificates) to a Swiss resident. Netherlands tax was then withheld on such dividends. The Swiss tax authorities refused to certify the Swiss resident’s claim for a refund, noting simply that they did not consider that he qualified for the refund.

The Gerechtshof denied the Swiss resident’s claim for a refund – on the grounds that he did not fulfil the beneficial ownership requirement in the Competent Authority Agreement. It did not, therefore, have to address the Netherlands tax authorities’ additional argument that treaty relief should be denied because the Swiss tax authorities had not certified his claim – so that the procedures for obtaining such relief, which the competent authorities had formulated pursuant to the authority given to them by Ad. Article 9(4), had not been fulfilled. Curiously, the Swiss resident does not seem to have contested the validity of the competent authorities’ beneficial ownership requirement on the grounds that it exceeded the authority given by Ad. Article 9(4).

27.07 Do Article 4(1)(d) State of residence agreements have the force of law?

Article 4(1)(d) is the only provision in the 1977 and 1992 OECD Models which seems to require Contracting States to settle any differences in their views.

Article 4(1)(d) provides that when the final tie-breaker criterion (nationality – in Article 4(1)(c)) cannot apply because an individual is “a national of both States or of neither of them, the competent authorities of the Contracting States *shall* settle the question by mutual agreement” (italics added).

At a public international level (where individuals have no standing – see Chapters 16.01 and 27.02) taxpayers have no right to require competent authorities to comply with any Article 4(1)(d) obligation. At a domestic level, however, provisions comparable to Article 4(1)(d) may give rights to taxpayers.

Avery Jones *et al.* argue (1979, 342) that taxpayers cannot challenge an Article 4(1)(d) competent authority mutual agreement determining a sole State of residence. They conclude that this Article 4(1)(d) “delegation to the competent authorities of power to settle the question of dual residence is sufficiently clear for there to be no doubt that the result of the agreement could not be subsequently disputed in the courts.” However, Footnote 47 then adds that the position is more complicated than this “because the competent authorities’ power to settle the question arises after all the other tests in Article 4(2) have failed, and it may be that this point could arise only after court proceedings have settled those questions. It seems that the taxpayer’s acceptance of the mutual agreement is not necessary in view of the express wording that the competent authorities shall settle the issue. Even then it may be possible in some countries to object to the mutual agreement in the courts on such grounds as the agreement erroneously concerned a different taxpayer.”

The correct interpretation of Article 4(1)(d) is that Article 4(1) requires its tie-breaker residence criteria to be applied *seriatim* (i.e. in their prescribed order) – and, under Article 4(2), a mutual agreement can only be a measure of last resort. Any competent authority agreement which incorrectly interprets these criteria must be susceptible to being “subsequently disputed in the courts”. Furthermore, it is arguable that no taxpayer can be bound by a mutual agreement which he disagrees with – precisely because no such agreements have the force of law.

Thus, France: *May 13 1983 CE* (Article 4) held that neither it nor the (individual) litigant was bound by an agreement between the US and French competent authorities that the individual was to be regarded as a resident of France. Article 3(3) of the 1967 US tax treaty provided that its various “tie-breaker” criteria were to be applied *seriatim* – which the competent authorities had not done. The correct application of these criteria gave a result different to that agreed – so the Conseil d’Etat overruled the agreement.

Commissaire Bissara focused on (presumably Para. 28 of) the Commentary on Article 25 of the OECD 1977 Model – which provides that a mutual agreement is generally only binding on a taxpayer if he accepts it (see Chapter 27.09). He also focused (see Chapter 26.12) on Koch (1981, 105-107 and see Chapters 27.16 and 30.03) who concluded that courts are generally not bound by any competent authority determinations. Commissaire Bissara supported these views, noting that it was possible for tax authorities to negotiate a “package” compromise involving several different

taxpayers. In such a compromise (or “horse-trade”) the two States might simply agree on a split of, say, revenue – and ignore these taxpayers’ legal positions (as was the case in *May 13 1983 CE*).

Furthermore, it is arguable that such residual power as Article 4(1)(d) grants to competent authorities is restricted to dual or third State nationals or stateless persons. This is because Article 4(1)(d) only gives competent authorities power in relation to a person who “is a national of both States or of neither of them”. It is arguable that, as regards a taxpayer who is a national of only one of the Contracting States, any competent authority agreement on a sole State of residence can be “subsequently disputed in the courts” – because two States can only agree on a sole State of residence when an individual is “a national of both States or of neither of them”.

In practice, however, any person (including a national of only one of the Contracting States) may welcome a competent authority determination on a sole State of residence.

27.08 Unilateral competent authority provisions

Also unlike the 1977 OECD Model, some tax treaties give competent authorities unilateral powers to implement a tax treaty’s provisions with Regulations – see, notably, Chapter 28.02.

27.09 Do specific case provisions have the force of law?

Lenz described (1960, 304) the specific case procedure as: “... the application of the agreement in a particular case or to a group of cases for which the authorities wish to coordinate their discretionary power ...” He took the view that such specific case competent authority agreements did not have the force of law, and could not bind domestic courts. There are several reasons why this view is correct.

Firstly, the resolution of specific cases will typically amount to a compromise – either between States alone or between one or more States and one or more taxpayers. Such compromises may be wholly at variance with the wording of a tax treaty. However, if such a compromise only involves two States, they can agree (between themselves) to change their original bargain – see Chapter 16.01. If such a compromise involves a taxpayer, he may also agree it – irrespective of its correctness. Nevertheless, because such an agreement may exceed the tax authorities’ actual powers, a taxpayer may be unable to enforce it – although he might be able to allege breach of contract or estoppel (see Chapter 27.29).

Secondly, any specific case agreement (excluding, possibly, a State of residence agreement – see Chapter 27.07) is dependent upon the taxpayer concerned accepting it. Para. 28 of the Commentary on Article 25(2) of the 1977 OECD Model (renumbered Para. 31 of the 1992 OECD Commentary) confirms that a taxpayer is not bound by a specific case mutual agreement unless he accepts it. In the US it is also accepted that a taxpayer is only bound by a mutual agreement if he accepts it – see Rev. Proc. 70-18 (1970-2 CB 493, discussed by Avery Jones *et al.* 1979, 338 footnote 22).

Thirdly, precisely because specific case agreements do not have the force of law in

some States, effect may not be able to be given to them in these States if they conflict with a court decision. Apparently some States (such as Belgium, Germany, the Netherlands, Sweden and Switzerland) may permit such agreements to override a final domestic decision – see Avery Jones *et al.* (1979, 341). However, as Para. 23 of the Commentary on Article 25 of the 1977 OECD Model (renumbered Para. 24 of the 1992 OECD Commentary) notes: “In other States, the competent authority is bound by the court decision.” This may preclude effect being given to such agreements – a possibility also recognised in the context of the EU draft Arbitration Convention (see Chapter 2.05).

A conflicting court decision will typically arise if, in addition to invoking the specific case competent authority procedure, a taxpayer starts parallel court proceedings. The initiation of such proceedings is not inconsistent with invoking the specific case competent authority procedure. Indeed, it may be necessary – again because any agreement reached under this procedure may not have the force of law.

Para. 111 of the 1984 OECD *Mutual Agreement Report* (see Chapter 23.10) considers the possibility of a final court decision precluding the implementation of a competent agreement. It comments: “... no evidence was produced to the Committee to indicate that this was a widespread problem demanding an urgent solution.”

Nevertheless, precisely because court proceedings can give the force of law to agreements which would otherwise lack such force, Para. 112 of this Report does not recommend that States should require taxpayers to exhaust domestic legal remedies before they consult with treaty partner States. It recognises that parallel court proceedings may have the advantage of providing a legal basis, by way of a settlement or compromise, for any agreement between competent authorities and taxpayers. Accordingly, Para. 112 expressly approves of parallel court and competent authority proceedings – “[s]o long as the domestic appeal proceedings are not finalised and can be abandoned or concluded by a compromise settlement ...” This proviso again illustrates that specific case agreements do not have the force of law – unlike a final domestic decision (which may bind competent authorities and preclude them reaching a mutual agreement). As Para. 112 notes earlier: “... in many cases there would be a possibility of conflict between the outcome of the mutual agreement procedure and the outcome of the domestic appeal proceedings with the result that the agreement reached by the competent authorities could not be implemented.”

Fourthly, the final sentence of Article 25(2) of the 1977 and 1992 OECD Models implicitly recognises that the specific case mutual agreement procedure may be lengthy – and that the effective application of any agreements reached thereunder may be precluded by domestic statutes (such as those imposing time limits). It therefore provides: “Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.”

An identical sentence appeared in the 1977 US Model – and in the 1981 US Model which, after the words “time limits”, included the words “or other procedural limitations”. Furthermore, the US often includes comparable provisions in its tax

treaties – see Rev. Rul. 72-437 (Article 25 and see Chapters 16.01 and 27.23).

The validity under domestic law of such provisions is questionable – as Para. 27 of the Commentary on Article 25(2) of the 1977 OECD Model recognises. Para. 27 notes that some mutual agreements may not be capable of implementation – because, for “constitutional or other legal grounds”, they may not be capable of overruling time limits under domestic law. These words also appear in Para. 28 of the 1992 OECD Commentary.

The above constitutional or other legal reasons have partly prompted the numerous Reservations on Article 25 of the 1977 OECD Model – and the even more numerous Reservations on Article 25 of the 1992 OECD Model. For example, Paras. 50-54 of the Commentary on Article 25 of the 1992 OECD Model indicate that Belgium, Canada, Greece, Ireland, Italy, Portugal, Spain, Switzerland, Turkey and the UK all consider that the implementation of reliefs and refunds following a specific case mutual agreement ought to remain linked to time limits prescribed by their domestic laws.

However, domestic laws may extend normal domestic prescriptive periods in some (tax treaty) situations. For example, the UK’s s.806(2) ICTA 1988 provides that where tax adjustments (as a result, for example, of intercompany pricing adjustments) render tax treaty credits excessive or insufficient, the UK’s normal six year prescriptive period shall not apply.

27.10 *The interpretative provision in Article 25(3) of the OECD Models*

Article 25(3)’s first sentence runs: “3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention.”

In relation to Article 25(3), Para. 31 of the 1977 OECD Commentary runs: “31. Under this provision the competent authorities can, in particular:

- where a term has been incompletely or ambiguously defined in the Convention, complete or clarify its definition in order to obviate any difficulty;
- where the laws of a State have been changed without impairing the balance or affecting the substance of the Convention, settle any difficulties that may emerge from the new system of taxation arising out of such changes.”

As indicated in Chapter 27.05, Para. 31 may conflict with Article 3(2) of the 1977 OECD Model.

Para. 31 of the 1977 OECD Commentary is re-numbered Para. 34 of the 1992 OECD Commentary. After repeating that competent authorities can complete or clarify incomplete or ambiguous definitions, and settle differences emerging from tax changes, Para. 34 adds that they may “– determine whether, and if so under what conditions, interest may be treated as dividends under thin capitalisation rules in the country of the borrower and give rise to relief for double taxation in the country of residence of the lender in the same way as for dividends (for example relief under a parent/subsidiary regime when provision for such relief is made in the relevant bilateral convention).”

27.11 Do Article 25(3) interpretative agreements have the force of law?

Article 25(3) envisages that competent authorities should be able to make subsequent agreements – the permissible scope of which may be restricted by Para. 31 of the 1977 OECD Commentary, Para. 34 of the 1992 OECD Commentary, and Article 3(2).

However restricted this scope may be, it is more than possible that interpretative agreements do not have any legal force under some States' domestic laws – because in reality their true nature is legislative. This is a fairly recent view.

Lenz took the view that interpretative (and legislative – see Chapter 27.21) provisions in tax treaties did endow tax authorities with the power to “supplement” tax treaties – so that agreements reached thereunder had the force of law and bound domestic courts.

Lenz commented (1960, 304):“... when the administrative authorities consult with each other with a view to supplement the agreement, they make use of powers which have been delegated to them by the legislative bodies. These powers may be delegated to the administrative authorities by virtue of the provisions relating to the mutual agreement procedure which often allow consultations in cases where double taxation is not avoided by the agreement. The delegation of these powers may also be based on a provision of the agreement authorizing the administrative authorities to supplement the agreement or to give an authentic interpretation thereof with respect to specified points. Providing the administrative authorities do not exceed the powers which have been delegated to them, the decisions reached during a mutual agreement procedure of this kind are binding on the courts.”

More recently, however, Avery Jones *et al.* (1979, 346-353) and, in a splendid paper, Avery Jones (1980, 557), have correctly observed that provisions such as Article 25(3) do not square with the constitutional reality in some States – even though they may often be included in these States' tax treaties.

Because mutual agreement provisions comparable to Article 25(3) of the 1977 and 1992 OECD Models may be ineffective in many States, the OECD Model may be revised – perhaps to ostensibly permit legislative (i.e. tax-levying) powers to be delegated to competent authorities. Such a revision would probably have to be accompanied by a revision of Article 3(2) – see Chapter 27.05.

The 1992 ALI Report warns that interpretative agreements may have no legal force in treaty partner States – even when a tax treaty permits competent authorities to reach agreement on the meaning of (some) terms (see US: March 17 1988 *Xerox* (Article 23), discussed in Chapter 27.18). It notes (37, Footnote 126): “Negotiators should be conscious of possible limitations on the enforceability of competent authority interpretations under the law of the treaty partner, and if such limitations exist, consideration should be given to addressing a greater number of interpretative issues directly in the treaty itself.”

There are two constitutional arguments why interpretative agreements reached under provisions comparable to Article 25(3) do not have the force of law domestically.

Firstly, a taxpayer's rights and obligations at a domestic level will already have been fixed – at the time the tax treaty entered into force. No mere “agreement” between

competent authorities can subsequently override domestic law and change these rights to a taxpayer's disadvantage – see Chapter 27.09.

Secondly, at a domestic (as opposed to a public international) level, subsequent interpretative agreements should be given little, if any, weight – because they may be self-serving. Treaty partner States have an obvious interest in agreeing on an interpretation which will advantage one or both of them – and not taxpayers. This may amount to the imposition of tax. Some courts (notably UK courts – see Chapter 27.17) have therefore refused to accept that competent authorities have been delegated any interpretative powers. However, other courts have accepted that competent authorities have been delegated interpretative powers – of such width that, in some cases, they are tantamount to legislative powers. The following examples illustrate some of these divergent positions.

27.12 *Belgium, Denmark, France*

Belgium: *November 7 1961 CC* (discussed in *Avery Jones et al.* 1979, 346 n. 62) held that a competent authority agreement did not have the force of law, and should only be taken into account as a possible interpretation.

Belgium: *June 29 1982 Antwerp CA* (Article 5) disregarded a competent authority agreement under the 1970 Netherlands tax treaty on when different building sites constituted a permanent establishment – because this agreement did not accord with the treaty's terms.

Denmark: *May 22 1985 Tax Court* (Article 2) upheld the validity of a publicised 1977 Exchange of Letters confirming that the 1957 France tax treaty did not cover capital gains on the sale of property. This decision has been criticised – see, for example, 1986 *European Taxation* 114.

France: *April 12 1988 Paris TA* (Article 4) involved Article 13 of France's Law 76-1234 (since codified in amended form as Article 209A CGI). Under this provision, foreign entities owning French property from which they receive less than the market rent are subject to tax on three times the market rent. The French tax authorities argued that a Swiss SA could not invoke an exemption under the 1966 Switzerland tax treaty because, following a January 14/15 1985 meeting of the Franco/Swiss Joint Commission, the Swiss tax authorities had admitted France's right to take measures (such as Article 13 of Law 76-1234) to combat fraud and fiscal evasion.

The Tribunal Administratif refused to take account of the meetings of the Joint Commission. However, because it found the tax treaty exemption to be unclear, it asked the Minister of Foreign Affairs to give an opinion on its meaning.

Because French administrative courts used to follow unilateral opinions by the Minister of Foreign Affairs (see Chapter 28.08), they have accorded comparable binding force to bilateral interpretative agreements by the French competent authorities who (strictly speaking, act on this Minister's behalf – even though, in practice, they are members of the Ministry of Finance).

Thus France: *July 8 1988 CE* (Article 17) interpreted the 1964 Belgium tax treaty in

line with a subsequent (December 17 1965 and January 4 1966) Exchange of Letters between the Belgian and French competent authorities. The Commissaire concluded that the Conseil d'Etat could hardly ignore the interpretation of the tax treaty given by the French competent authorities – because, if it referred the matter to the Minister of Foreign Affairs for his opinion, he would undoubtedly confirm their interpretation.

At that time, French administrative courts normally considered themselves bound by the Minister of Foreign Affairs' opinion – so the Commissaire's fatalistic (and, arguably, cynical) conclusion was more understandable. Today, however, they no longer regard themselves as bound by such an opinion (see Chapter 28.09) – so the chances of them disregarding such competent authority agreements may have increased.

France: *February 16 1990 CE* (Article 24) involved Article 23 of the 1936 Sweden tax treaty. Article 23 runs: "The Contracting States instruct their several supreme revenue authorities to conclude agreements or special arrangements for the avoidance of double taxation in the case of direct taxes on income or capital which are found to conflict with the purposes of the present Convention in circumstances for which Section I does not specifically provide, as also in the event of any difficulties of execution or interpretation which may arise."

Pursuant to Article 23, the French and Swedish competent authorities agreed, in a 1973 Exchange of Letters, how this treaty's benefits could be obtained. These Letters were only published as an annexe to the French tax authorities' April 25 1975 Instruction (BODGI 14-B-3-75).

The French tax authorities argued that SAS Consortium, a Swedish company, should be denied this treaty's benefits – because it had not made an application vetted by the Swedish tax authorities, as contemplated by the 1973 Exchange of Letters.

The Conseil d'Etat held that, to obtain this treaty's benefits, SAS Consortium was not obliged to follow the procedures laid down in the 1973 Exchange of Letters. These Letters had not been ratified or approved (as treaties) by the Contracting States; they had not even been published in the *Journal Officiel* – see Chapter 21.04.

27.13 Germany: October 9 1985 BFH and January 20 1993 BFH (both Article 7)

In Germany: *October 9 1985 BFH* (Article 7 and see Chapters 6.05 and 17.02), the German Federal Ministry of Finance argued that its interpretation of the 1954 US tax treaty was consistent with its practice, and that of the IRS, in administering the treaty over the past 30 years. It argued that this reciprocal practice should be accorded weight – especially as the IRS and the UK Inland Revenue had also agreed on a comparable interpretation, as evidenced by US: Rev. Rul. 77-269 and a joint statement (US: January 12 1977 Release IR-733, discussed in Chapter 27.17) (both Article 7). Furthermore, this IRS interpretation had been upheld by US: May 5 1982 *Great-West* (Article 7) in relation to the 1942 US/Canada tax treaty – see Chapter 6.05.

October 9 1985 BFH held that the ordinary meaning of the tax treaty terms did not correspond with these three revenue authorities' interpretations – or *Great-West*.

However, *January 20 1993 BFH* conflicts squarely with *October 9 1985 BFH* – see Chapters 6.05 and 11.03.

27.14 Italy

The tax authorities in Italy (a civil law country) have taken advantage of the fact that a competent authority agreement may have no force at a domestic level.

In Italy: *May 24 1988 CC* (Article 12) the Italian tax authorities successfully advanced arguments which renege – to a taxpayer’s disadvantage – on an interpretation they had bilaterally agreed with France in competent authority meetings.

The taxpayer argued that its interpretation of a term in the 1958 France tax treaty was consistent with the views of both Contracting States. On July 8-11 1968 the France-Italy Joint Commission set up under Article 26 of this treaty had resolved that both States would interpret this term in line with the taxpayer’s interpretation. This agreement was evidenced in a written summary of the Joint Commission’s proceedings – and the taxpayer argued that this agreed meaning should prevail. (It is unclear whether any estoppel arguments were advanced – see Chapter 27.29.)

The Corte di Cassazione upheld the Italian tax authorities’ assessment – even though it conflicted with the Joint Commission’s position. The Corte di Cassazione focused on Article 26(4) of the treaty, which provides that the Joint Commission could sit “in order to arrive at an agreement”. These words made it clear that the Joint Commission’s meetings were simply a phase in the negotiation process – and that its findings could not, by definition, be considered as forming part of the treaty itself. Its findings could have no domestic legal effect in Italy – unless and until they were included in a formal treaty between the two Contracting States which was incorporated into domestic law pursuant to Articles 80 and 87 of the Constitution.

27.15 Monaco

Monaco: *October 31 1991 Monaco Tribunal* (Article 25) involved Article 24 of the 1963 French tax treaty which runs: “The French tax administration and the Monegasque tax administration shall reach agreement with a view to the avoidance of double taxation in cases not provided for in this Convention, and in cases where the interpretation or application of this Convention gives rise to difficulty or doubt. If they fail to reach agreement, the matter shall be referred, at the request of either Party, to the joint consultative commission provided for in the following article.”

Article 25 runs: “The Parties shall establish a joint consultative commission, which shall meet at the request of either Party. This commission shall be composed of representatives of the administrations concerned of each State. The commission’s task shall be to examine any difficulties arising in the interpretation or application of this Convention which cannot be settled through diplomatic channels and to propose a solution to the Parties.”

The Monegasque tax authorities argued that the total receipts of Manhattan’s Chase Monegasque branch should include the receipts of its French branch – so that an

identical percentage amount of VAT would be reclaimed in both France and Monaco. This argument accorded with the views of the Monaco/France Joint Commission (set up under Article 25 of the treaty) as expressed in its June 26 and 27 1986 meetings.

Chase Manhattan argued that although Monaco and France agreed to impose identical VAT régimes (under Article 15 of the tax treaty) and to share VAT receipts (under Article 17 of the tax treaty), Monaco's fiscal sovereignty remained unaffected. Accordingly, the total receipts of the Monaco branch should only include its receipts – and not the French branch's receipts.

Despite the opinion of the Joint Commission, the Tribunal upheld Chase Manhattan's argument. Although the two States' VAT régimes were analogous, they remained autonomous. French VAT legislation was not directly applicable in Monaco; Article 15 of the tax treaty was consistent with the view that Monaco levied its own VAT, subject to its own territorial rules.

27.16 Norway: November 9 1992 Supreme Court (Article 25)

November 9 1992 Supreme Court involved an interpretation “agreed” in an exchange of correspondence between the Norwegian and Swiss competent authorities in late 1982. It found this “agreement” to be conclusive – even though in 1986 the Swiss competent authorities, arguably revising their interpretative position, claimed that no “agreement” had in fact ever been reached.

Article 10(2) of the 1956 Switzerland tax treaty ran in part: “The competent authorities of the two States shall also endeavour to come to an agreement for the elimination of double taxation in cases not provided for in this Convention, as well as in cases where the interpretation or application of this Convention gives rise to difficulties or doubts.”

The Supreme Court held that Article 10(2) gave the competent authorities of each State power to conclude agreements regarding “the interpretation or application” of the treaty – and that their “agreement” only concerned the interpretation or application of the treaty.

The Gulating Court of Appeals, citing the Vienna Convention, had held that the two States had agreed in 1982 that activities on Norway's Continental Shelf (i.e. outside Norway's territorial waters) were to fall outside “the territorial scope” of the convention. Accordingly, it held that Heerema (a Swiss resident engineering company carrying on activities on Norway's Continental Shelf) was unrestrictedly subject to Norwegian tax on its profits from these activities – whether or not it had a permanent establishment in Norway. This holding was upheld by the Supreme Court.

The Supreme Court was influenced by the Norwegian tax authorities' argument that, had Norway taken the view in 1982 that no “agreement” had in fact been reached, it would have immediately asked for the treaty to be renegotiated to include such an “agreement”. Indeed, the successor 1987 Switzerland tax treaty does include, in Para. 1 of its contemporaneous Protocol, an understanding that the term “Norway” does not include its Continental Shelf. (The Supreme Court took the view that such a provision

enables Norway to unrestrictedly tax activities on the Continental Shelf. However, it is arguable that this view is inaccurate – see the *Editorial* on this decision in *The International Tax Treaties Service*.)

Several criticisms can be levied against *November 9 1992 Supreme Court* – discussed by Skaar (1993, 189), Sollund (1993, 105) and Weizman (1993, 264).

Firstly, even if it was appropriate to give effect to the 1982 “agreement” *as between the two States (Norway and Switzerland) themselves*, it may well have been inappropriate for this agreement to affect taxpayers – if only because it may not have received adequate publicity (see Chapter 21.04). The Norwegian tax authorities cited Para. 33 of the Commentary on Article 25(3) of the 1977 OECD Model in support of its argument that the “agreement” was binding on the two tax authorities. However, Para. 33 says nothing about the effect of such agreements on taxpayers – see Chapters 16.01 and 27.02.

Secondly, the Supreme Court did not have to consider the argument, discussed by Oliver (1990, 303) and in the *Editorial* on this decision in *The International Tax Treaties Service*, that the aim of a tax treaty is to avoid all double taxation – irrespective of territorial scope. The taxpayer chose not to advance this argument in the Supreme Court – even though it had been advanced by the Swiss tax authorities in 1986 (when they also argued that no “agreement” had in fact been reached).

Thirdly, the agreement did not result in “the elimination of double taxation” – a requirement which exists both as regards “cases not provided for in this Convention” and “cases where the interpretation or application of the Convention gives rise to difficulties or doubts”. Indeed, the agreement probably resulted in double taxation.

Fourthly, an agreement which results in tax being imposed, when none would have been imposed in the absence of such an agreement, must be legislative by nature – and must therefore raise constitutional issues. The Norwegian tax authorities did refer to Koch (1981) who concluded (see Chapter 27.07) that opinions varied as to whether courts should be bound by competent authority agreements. However they argued that, under Norwegian law, the agreement “supplements the treaty itself with the same legal power as the treaty”. The Supreme Court sidestepped this argument and held that the agreement did not fall within Article 10(2)’s “legislative” phrase covering “cases not provided for in this Convention” – because it was purely interpretative. However, this holding, seemingly based on the Norwegian tax authorities’ (additional) argument that the agreement “does not limit or amend any provision of the Convention, but merely defines more precisely and expressly its territorial scope”, is unconvincing.

27.17 UK: February 9 1990 Commerzbank (Article 7)

The differing force of competent authority agreements reached under an express authority in a tax treaty is illustrated by Article XXA(2) of the UK/US 1945 tax treaty, which was added by the March 17 1966 Protocol.

Article XXA(2) was a mix of the interpretative provision in the 1977 OECD Model’s Article 25(3)’s first sentence and the communication provision in its Article 25(4).

Article XXA(2) authorised the competent authorities to communicate with each other to implement the provisions of the Convention and “to assure its consistent interpretation and application”.

Nearly eleven years after the signature of this 1966 Protocol, US: January 12 1977 Release IR-733 (Article 7) was published. It consists of a joint statement by the US Internal Revenue Service and the UK Board of Inland Revenue. It runs in part (*italics added*): “2. Having conferred in accordance with the provisions of paragraph (2) of Article XXA of the Convention, to assure its consistent interpretation and application, the Competent Authorities of the Contracting States are agreed that they will maintain their view that dividends and interest effectively connected with the permanent establishment ought to be treated as commercial profits of the permanent establishment within the meaning of Article III and are not entitled to exemption from tax under Article XV. The Competent Authorities affirm that *this interpretation reflects the intentions of the Contracting States* when Article XV of the Convention was amended by Protocol in 1966.”

The italicised words supposedly affirm, in 1977, what the intentions of the two Contracting States were when they amended the treaty in 1966. It is difficult to conceive of more convincing evidence of the suitability, at a domestic level, of a textual approach to tax treaty interpretation (see Chapter 6). The parties’ “intentions” are best discovered, not in a self-serving announcement over a decade later, but in the ordinary meaning of a tax treaty’s terms.

In UK: February 9 1990 *Commerzbank* (Article 7) this joint statement, plus a second source, was invoked by the Revenue in support of its argument as to the meaning of the 1945 US treaty. (This joint statement was also referred to in Germany: *October 9 1985 BFH* – Article 7 and see Chapter 27.13.)

The second source invoked by the UK Revenue in *Commerzbank* was US: May 5 1982 *Great-West* – which Germany: *October 9 1985 BFH* had already declined to follow and which Mummery J. also distanced himself from (see Chapter 6.05).

Mummery J. commented ([1990] STC 304) that references to US tax law at the time of the 1945 US tax treaty (see Chapter 24.01), *Great-West* (see Chapter 29.15) and the joint statement “do not fall within the description of material to which recourse may be had as an aid to interpretation in accordance with the decision of the House of Lords in *Fothergill v. Monarch Airlines Ltd.*” – see Chapters 3.13 and 3.14.

Mummery J. correctly held ([1990] STC 302): “... this joint statement has no authority in the English courts. It expresses the official view of the revenue authorities of the two countries. That view may be right or wrong. Although art XXA authorises the competent authorities to communicate with each other directly to implement the provisions of the convention and “to assure its consistent interpretation and application” it does not confer any binding or authoritative effect on the views or statements of the competent authorities in the English courts.”

Baker comments (1991, 327 and 1994, 422) that this “... denunciation of the effect of mutual agreement procedure rather overstates the position. Article 25(3) requires

competent authorities to endeavour to resolve any difficulties or doubts as to the interpretation or application of the convention. There is little point in resolving the difficulties if the mutual agreement has no force at all. The decision also fails to recognise the practical reality that an agreed interpretation of a treaty could be embodied in a protocol which would then be binding on the courts; the interpretative provision of the mutual agreement procedure allows the competent authorities to agree an interpretation without the formality of a protocol.”

I have two comments on Baker’s criticism that *Commerzbank* “fails to recognise the practical reality that an agreed interpretation could be embodied in a protocol which would *then* be binding on the courts” (italics added).

Firstly, Mummery J. did recognise that an agreed interpretation could be embodied in a protocol; more importantly, he also recognised that, because the statement had not been embodied in a protocol, it was not binding. Quite correctly, Mummery J. refused to construe the statement as if it had been embodied in a protocol.

Secondly, the practical reality is that embodiment in a protocol can be done fairly easily (as Lord Fraser of Tullybelton observed many years ago in *Fothergill* – see Chapter 15.02). Precisely because this is so, UK courts must only concern themselves with such embodied agreements – and with the constitutional and legal reality that, in the UK, mutual agreement provisions in tax treaties are simply not capable of endowing tax authorities with interpretative (i.e. legislative) powers.

The 1992 ALI Report seemingly seeks to explain away Mummery J.’s holding as regards the joint statement. Perhaps because the US has not ratified this Convention (see Chapter 3.01), it comments (34, Footnote 110) that it arose: “in a case to which the Vienna Convention did not apply ...” This comment could be regarded as misleading – for two reasons.

Firstly, courts in Australia (see Chapters 3.03 and 23.25) and the UK (see Chapters 3.01 and 3.13) recognise that the principles expressed in the Vienna Convention can apply even when one party has not ratified it – and even when a tax treaty pre-dates it. Indeed, Mummery J. himself held ([1990] STC 298) that UK courts should apply “the general principle of international law, now embodied in art 31(1) of the Vienna Convention on the Law of Treaties, that “a tax treaty should be interpreted in good faith and in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose”.” Therefore, the Vienna Convention did apply, and was applied, in *Commerzbank*.

Secondly, this comment implies that Mummery J. would have held differently in a case in which the Vienna Convention clearly did apply. However, Mummery J. would doubtless have made an identical holding in a case in which the Vienna Convention clearly did apply. This is precisely because a mutual agreement (not having been enacted) has no force of law in the UK – even if reached pursuant to an authority such as that contained in Article XXA of the 1945 UK/US tax treaty and irrespective of the Vienna Convention (which, in any event, only applies as between States).

Avery Jones commented (1990, 390 and 391 and 1991, 37) that in *Commerzbank* the

“object and purpose” of the treaty required that the exemption not apply, and that the mutual agreement should have been “taken into account” under Article 31(3) of the Vienna Convention “although it is not directly in point here as the third state banks were not enterprises of one of the Contracting States, so that the permanent establishment article did not apply to them.” Similarly, Baker commented (1991, 327 and 1994, 422) that *Commerzbank* “... ignores the provisions of the Vienna Convention on the Law of Treaties”, Articles 31(3)(a) and 31(3)(b) of which provide that account should be taken of subsequent agreements and practice.

However, as indicated in Chapters 1.01, 1.05, 3.13, 16 and 17, both these comments could also be regarded as misleading – because Articles 31(3)(a) and 31(3)(b) are primarily relevant at a public international level *as between States themselves*, and do not govern taxpayers’ rights under domestic law.

In reply to Avery Jones (1990, 390), White commented (1991, 35): “... there are powerful arguments which support the contention that the 1977 competent authority statement should not have been “taken into account” in the decision of the Court ...” White also explained the statement’s background. It was made *after* a taxpayer had won a claim comparable to *Commerzbank*’s before the Special Commissioners in 1975 – a fact which was not publicised, *after* two years of Revenue negotiations with this (and other) taxpayer(s) – facts which were not publicised, and *after* the enactment of s.50(1) of the UK Finance Act 1976, “which covertly dealt with the position of loss carry forwards in the event of the law being in accordance with the decision of the Special Commissioners”. White concluded (1991, 36): “These circumstances hardly make the July 1977 statement admissible as credible evidence to be adduced in interpretation.”

These circumstances also explain why Chapter 21.07 recommends that bilateral competent authority agreements reached in anticipation of litigation should be given no more weight than any other Government argument.

27.18 *The position in the US*

In contrast to UK: February 9 1990 *Commerzbank* (Article 7), US courts have given bilateral agreements even more weight than the considerable (even excessive) weight they have given to unilateral US legislative history – see Chapter 25.09 onwards. They have generally held subsequent mutual agreements to be conclusive as to the meaning of tax treaty terms – in line with the 1992 ALI Report’s recommendations (see Chapter 27.20).

For example, US: March 17 1988 *Xerox* (Article 23 and see Chapters 25.09 and 25.10) involved Article 25(3) of the 1975 UK tax treaty which took effect in 1980.

Article 25(3) provides that the competent authorities “shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application” of the treaty.

In an exchange of correspondence in late 1986, the UK and US competent authorities “agreed” on an interpretation involving the UK’s ACT (Advance Corporation Tax) and

a corresponding US foreign tax credit.

In Futey J.'s words (14 Cl.Ct. 468, footnote 8 omitted): "As for the Competent Authority Agreement, plaintiff asserts that it is weak on content – a collection of "self-evident and non-controversial statements which are more consistent with plaintiff's position than defendant's." More importantly, according to plaintiff, neither the Competent Authority Agreement nor the Technical Explanation addresses the central issue in this case – the significance for Xerox of RXL's surrender of section 85 ACT offsets. Accordingly, plaintiff maintains that none of these materials provides a reliable guide as to the intent of the treaty parties. Thus, they should not be accorded much evidentiary weight in this action."

Futey J. held (14 Cl.Ct. 466 and 467): "... plaintiff can hardly minimize the importance of the Competent Authority Agreement as an expression of the intent of the treaty parties, since Article 25(3) of the Convention specifically empowered the competent authorities "to resolve ... any difficulties or doubts arising as to the interpretation or application of the Convention." Courts have traditionally been reluctant to impinge on the judgments of competent authorities charged by the treaty states with responsibilities of interpretation and implementation. *Sumitomo Shoji America Inc. v. Avagliano*, 457 U.S. 176, 185, 102 S.Ct. 2374, 72 L.Ed.2d 765 (1982); *Filler v. Commissioner* [May 27 1980 *Filler* – Article 25], 74 T.C. 406, 408-09 (1980); *See also Collins v. Weinberger*, 707 F.2d 1518, 1522-1523 (D.C. Cir. 1983). As the Supreme Court stated in *Sumitomo*, 457 U.S. at 185, 102 S.Ct. 2379, "Our role is limited to giving effect to the intent of the Treaty parties. When the parties to a treaty both agree as to the meaning of a treaty provision, and that interpretation follows from the clear treaty language, we must, absent extraordinarily strong contrary evidence, defer to that interpretation."

This court finds no such "extraordinarily strong contrary evidence" in the case at bar, to the effect that the Competent Authority Agreement misinterprets the language of the Convention or the intent of the treaty parties. Nor does the court find this Agreement a relatively substance-less document generally favorable, as plaintiff alleges, to its position. To the contrary, as previously discussed, the court finds the Competent Authority Agreement strongly supportive of defendant's position on Article 23(1)(c). Moreover, the court finds this Agreement, along with the Technical Explanation and Rev.Proc. 80-18 [see Chapter 28.17], fully in accordance with the language of Article 23(1)(c) tying the US tax credit under Article 23(1)(c) not just to a dividend distribution, but "to tax paid to the UK." "

27.19 US: August 13 1992 Snap-On (Article 23)

In *Snap-On* the plaintiff sued for a refund of US tax on the basis that a 60-day rule (now abolished – see Chapter 25.12) did not apply. After the plaintiff initiated proceedings, the defendant moved to suspend the case pending a competent authority agreement under Article 25 of the 1975 UK tax treaty (partly cited in Chapter 27.18).

According to an affidavit by Philip E. Coates, Associate Commissioner (Operations)

of the IRS, this Agreement would address the 60-day rule and would be “binding on the court” or “highly persuasive evidence of the proper interpretation and application of the Treaty”. In the event, this Agreement did not address the 60-day rule – so the court did not have to address its validity. However, unlike *Xerox*, *Snap-On* held that the US Technical Explanation should be disregarded – see Chapter 25.12.

27.20 *The 1992 ALI Report's Recommendations*

Possibly influenced by the above approaches of US courts, the 1992 ALI Report invokes Article 31(3) of the Vienna Convention to conclude (34): “... a published mutual agreement under a tax treaty and subsequent practice establishing an agreement would have the same priority as the context of the agreement in determining its meaning.” This conclusion, which is mirrored in this Report’s Recommendation 4 (49, see the next paragraph) and its Recommendation 6 (52, see three paragraphs below), is acceptable at a public international level; it is, however, inappropriate at a domestic level – where tax treaties may have to be interpreted differently for the reasons summarised in Chapter 27.03.

On the basis that the 1981 US Model’s (additional) words (see Chapter 27.05) are included in a tax treaty, Recommendation 4 of the 1992 ALI Report runs (49): “4. An agreement by the competent authorities as to the meaning of a treaty term published subsequent to ratification of the treaty pursuant to express authority granted in the treaty is controlling unless the interpretation is so inconsistent with the meaning of the treaty term as it would otherwise be established that the agreement is tantamount to an amendment of the treaty.”

Recommendation 4 seems to assume that the express authority ostensibly delegated to competent authorities is adequate to give the force of law to their supposedly “controlling” agreements. In line with this, the 1992 ALI Report hardly focuses on whether tax authorities’ “agreements” on the meaning of tax treaty terms should be capable of binding taxpayers – a constitutional issue of major importance. This may be because, as indicated above, US courts tend to give considerable weight to subsequent agreements by competent authorities.

Even in the absence of express authority in a tax treaty, the 1992 ALI Report recommends (52): “6. ... substantial weight should ordinarily be given to relevant portions of: (a) A subsequently published bilateral administrative agreement or subsequent bilateral practice, whether a product of an express competent authority agreement or an identical interpretation by the administrative authorities of the treaty partner”.

It is arguable that these Recommendations give far too much weight to competent authority actions. For example, Recommendation 6’s suggestion that considerable weight should be given to subsequent *practice*, even in the absence of any provisions in a treaty giving any legal status to such practice, seems too broad – see Chapter 16. It ignores the vital distinction between interpreting a tax treaty at a public international level, and at a domestic level – and the fundamental constitutional principle in many

States that clear statutory authority is required before tax can be imposed.

27.21 *The legislative provision in Article 25(3) of the OECD Models*

Article 25(3)'s second sentence, the legislative provision, raises constitutional issues which are even more acute than those arising in the case of the (narrower) interpretative provision in Article 25(3)'s first sentence.

Article 25(3)'s second sentence has been called "legislative" (by, for example, Avery Jones *et al.* 1979, 335 and the 1992 ALI Report 95) because it ostensibly authorises competent authorities to consult together for the elimination of double taxation in cases *not provided for in the Convention*. However, the adjective "legislative" probably exaggerates this provision's intended purpose – and its permissible scope. A more appropriate adjective might be "consultative".

As regards purpose, it is arguable that even the US (which seems most in favour of this legislative provision) views it as being merely regulatory and as not having any legislative force. For example, when the US Senate considered the 1980 Malta tax treaty (S. Exec. Rept. No. 97-30, 97th Cong., 1st Sess. 27 (1981)), it construed this authority "as analogous to a grant of a broad regulatory authority ... not intended to deal with problems of major policy significance". The fact that Article 25(3) only authorises competent authorities to *consult* is consistent with this argument.

As regards permissible scope, the adjective "legislative" hints at the constitutional reasons why any "legislative" agreements (which, typically, will not have the force of law) may be ineffective domestically.

The constitutional issues raised by this ostensible (yet almost invariably ineffective) delegation of seemingly unlimited legislative powers are explicitly referred to in Para. 34 of the Commentary on Article 25(3) of the 1977 OECD Model (now renumbered Para. 37 of the 1992 OECD Commentary).

These Paras. comment that it is "desirable" that competent authorities should be able to eliminate double taxation even when this is outside the scope of the Convention.

They give an example of the application of this legislative provision: the avoidance of double taxation in the case of a resident of a third State having permanent establishments in both treaty partner States. This example clearly amounts to *tax authorities* giving rights to a resident of a third State – and these Paras. clearly recognise that, in some States, tax authorities may not be capable of avoiding double taxation in this way. Accordingly, their last sentence runs: "An exception must, however, be made for the case of Contracting States whose domestic law prevents the convention from being complemented on points which are not explicitly or at least implicitly dealt with; in such a case, the Convention could be complemented only by a protocol subject, like the Convention itself, to ratification or approval."

No doubt because of constitutional difficulties, many States (including Belgium and the UK, the two States where courts have clearly held that interpretative provisions have no legal force) typically omit this legislative provision from their tax treaties. For example, the UK has only included such a legislative provision in one tax treaty

(Article XXVII(3) of the 1967 Luxembourg tax treaty) – and this inclusion may have been inadvertent. Nevertheless, no Reservations have been made to this legislative provision in either the 1977 OECD or 1992 Models – perhaps because tax authorities are unwilling to advertise that *all* their powers under Article 25 may be much more limited than OECD Models suggest.

Because many States omit this legislative provision from their tax treaties, clear examples of agreements being reached under it are unknown. Avery Jones *et al.* cite (1979, 16 and 17) two possible examples, neither of which indicate the authority (if any) under which they were made. Since 1979, other comparable but equally unclear examples have appeared, as indicated in Chapter 27.23.

27.22 Competent authority agreements with no express authority

When competent authority agreements are concluded in the absence of any express authority in a tax treaty, they cannot rank higher than practice between States – and domestic courts should take little, if any, account of them (save in estoppel situations, see Chapters 27.29 and 28.19 onwards). However, tax authorities may have powers to waive taxes under non-treaty domestic law – for example, if taxation is inequitable or is waived reciprocally (see Chapter 12.01). Thus, Netherlands: June 14 1985 Ruling (Article 15) notes that, because the Swiss tax authorities consider themselves entitled to tax the earnings of Netherlands residents working on barges registered in Switzerland, the Netherlands tax authorities have often not exercised their right to tax such sums. See also Germany: November 28 1985 Federal Ruling (Article 18 and Chapter 27.23).

27.23 Examples of bilateral competent authority agreements

Some examples of competent authority agreements follow. Whether any of these agreements have the force of law at a domestic level will typically depend upon the constitutional position in the State concerned, and upon the precise terms of any relevant Mutual Agreement or comparable tax treaty Articles.

Austria: November 8 1990 Ruling (Article 24) holds that the Austrian tax authorities consider that Austrian restrictions on the carry forward of Austrian losses by Austrian permanent establishments do not infringe tax treaty Articles comparable to Article 24(4) of the 1977 OECD Model. The last paragraph of this Ruling holds that competent authorities may mutually agree to modify these restrictions if they infringe tax treaty non-discrimination provisions.

In Belgium: 1973 Agreement (Article 15) the competent authorities agreed that a relieving provision in Section XI of the Protocol to the 1970 Netherlands tax treaty would not apply to some “Dutch nationals” employed in the Dutch frontier zone who moved to live in the Belgian frontier zone. In May 12 1982 Reply Kelchtermans (Article 15) they then agreed that they would consider a person with both Dutch and Belgian nationality to be a “Dutch national”.

In France: January 22 1982 Instruction (Article 15) the competent authorities of France and Germany agreed on how they would interpret the relieving provisions

applicable to frontier workers.

France: May 9 1988 Reply Bachelet, following April 7 1976 Reply Fritsch (both Article 4), holds that the Joint Commission envisaged by Article 25 of the 1963 Monaco tax treaty has confirmed that French nationals who also possess a foreign nationality (including Monegasque) shall be considered as having French nationality.

France: January 19 1989 Reply d'Ornano (Article 4) holds that, in the light of an April 17 1978 and May 23 1979 Exchange of Letters, and January 20 and 22 1986 meetings of the Joint Commission, the children of French nationals residing in Monaco cannot, on reaching their majority, (also) claim an exemption from French tax.

France: May 14 1992 Reply de Cuttoli (Article 1) notes that the French and Luxembourg authorities had agreed in a September 8 1970 Exchange of Letters that Luxembourg holding companies were outside the scope of the 1958 Luxembourg tax treaty. Reply de Cuttoli accordingly holds that such holding companies cannot benefit from the Article 990 E, 2^e CGI exemption from the 3% annual tax on any French property they own.

In Germany: August 27 1965 Correspondence (Article 12) Stanley S. Surrey (Assistant Secretary, US Treasury) and Mr. Falk (of the German Ministry of Finance) confirmed that Germany would not tax (defined) know-how payments.

Germany has agreed with France (September 25 1973 Federal Ruling), Switzerland (September 12 1974 Lower Saxony Ruling) and Luxembourg (July 21 1975 NR Westphalia Ruling) (all Article 23) that a Government-owned banking institution may qualify as "a joint stock company" entitled to German tax exemption on dividends from foreign companies in which it owns at least 25% of the share capital.

Germany: July 9 1982 Federal Ruling (Article 15, involving Belgium) holds that the two competent authorities have agreed to exclude a person working for more than 45 "days" outside the frontier zone from the definition of a frontier worker.

In Germany: November 28 1985 Federal Ruling (Article 18) the German tax authorities noted that, despite using the Mutual Agreement procedure, they had been unsuccessful in changing the US tax authorities' view that they could tax US social security life annuities because they were not "private" life annuities. Accordingly, US tax withheld on such US annuities would be creditable against German tax.

Germany: October 13 1992 Federal Ruling (Article 15, involving Switzerland) notes a competent authority agreement on varying characterisations of severance payments or golden handshakes, some of which conflict with the former views of the Swiss tax authorities.

Netherlands: March 2 1965 Ruling (Article 15) holds that the Netherlands tax authorities will follow an interpretation by the French tax authorities that "short" means a period not exceeding 12 months.

Netherlands: March 25 1992 Ruling (Article 16) holds that the competent authorities of the Netherlands and Belgium have agreed to tax an active partner's income from an SPRL as directors' fees – see Chapter 10.12.

US competent authorities have entered into several more or less contemporaneous

interpretative agreements – such as US: October 18 1965 Memorandum (Article 10) which involved the (slightly earlier) September 17 1965 Protocol to the July 22 1954 Germany tax treaty. This memorandum began: “The representatives of the German Ministry of Finance and of the US Treasury Department hereby agree that the Protocol modifying the Income Tax Convention of July 22, 1954, between Germany and the USA shall be applied in accordance with the following principles: ...”

Far more lengthy contemporaneous agreements are now appearing, notably the material accompanying the 1992 US/India and 1993 US/Netherlands tax treaties.

Several US Revenue Rulings describe competent authority and comparable agreements.

Rev. Rul. 54-5 (Article 7) notes an agreement on the allocation of income from the cross-border operation of buses under the 1942 Canada tax treaty.

Rev. Rul. 65-4 (Article 18) notes an agreement that some US benefit payments paid to Swedish residents constitute US Government pensions, exempt from Swedish tax.

Rev. Rul. 67-143 (Article 10, involving Switzerland) notes an agreement that when a corporation’s sole class of outstanding stock is at least 50 percent owned by another corporation, it will be considered a subsidiary.

Rev. Rul. 69-128 (Article 8, involving Norway) notes an agreement that shipping or aircraft income derived by a general partnership with residents of both States as partners will be taxable in each partner’s State of residence in proportion to his partnership interest; furthermore, Norway will not tax capital invested by US resident partners.

Rev. Rul. 70-196 (Article 14, involving Japan) notes an agreement that the terms “educational establishments” and “other educational institutions” are to be defined by each State according to cited domestic laws.

Rev. Rul. 72-437 (Article 25) confirms that, as between themselves, numerous States must apply agreements reached by their competent authorities – see Chapter 16.01. Furthermore, credits or refunds due under such agreements may be paid even if barred by a domestic statute of limitations – a position also adopted by the last sentence of Article 25(2) of the 1977 and 1992 OECD Models (see Chapter 27.09).

Rev. Rul. 74-92 and Rev. Rul. 76-568 (both Article 8, involving Germany and the Netherlands respectively) note agreements that income from the transportation of containers by ships, and from ancillary activities, is from the operation of ships.

Rev. Rul. 75-402 (Article 2) notes an agreement that the prohibition of French taxes on US stock or commodity exchange transactions extends to over-the-counter transactions.

US: Rev. Rul. 76-170 and LR 81-29-115 (both Article 11) note that the US and Japan have agreed by an Exchange of Notes that when the Export-Import Bank of Japan provides funds to a resident of Japan to extend credit to a US resident, the debt obligation will be treated as indirectly financed by the Bank.

Rev. Rul. 77-62 (Article 7) holds: “Under the authority granted by Article 25(2) of the Convention, the Competent Authority of the Internal Revenue Service and the

French Ministry of Economy and Finance, Tax Administration Legal Department, have agreed pursuant to an exchange of letters to interpret the phrase “reinsurance premiums” to include investment income derived in connection with the conduct of a reinsurance business ...”

Rev. Rul. 77-289 (Article 20, involving Germany) notes an agreement that the tax exemption for grants from a non-profit organization shall be allowed without regard to its situs. Rev. Rul. 80-304 (Article 20, involving Austria) is comparable.

US: LR 92-24-034 (Article 13) notes a 1991 and 1992 exchange of letters interpreting the term “other entities” in the 1939 Sweden tax treaty – signed over half a century earlier.

27.24 Can competent authority agreements have retroactive effect at a domestic level?

Tax treaties are often expressed to be retroactive – i.e., to have effect prior to the time they are actually ratified – as US: August 25 1982 *Brown & Williamson* (Article 29 and see Chapter 12.04) illustrates. Such retroactivity can be denied on constitutional grounds – see, for example, Germany: *March 10 1971 BFG* (Article 29). Can any competent authority agreements have retroactive effect at a domestic level?

Irrespective of the extent to which a competent authority agreement can have effect at a domestic level, it should never have retroactive effect. Effect should only be given to agreements which have received adequate publicity – see Chapter 21.04. This publicity requirement conflicts squarely with retroactivity – because no agreement can be made public retroactively.

Although the 1992 ALI Report recognises (48) that “unpublished documents should be given substantially less weight than published material or even excluded from the interpretative process”, it does not express great concern about retroactivity. It simply comments (50): “The application of a competent authority agreement to a case arising prior to its conclusion (or publication) raises fundamental issues of fairness. Taxpayers obviously may have proceeded on the basis of their own conclusions (whether ultimately justified or not) as to the meaning of treaty language. While the treaty language giving the competent authorities the power to enter into an interpretative agreement contains no suggestion that such agreement can have only prospective effect, the reasonableness of a retroactive application obviously depends upon the nature of the agreement, the reasonable prior understanding of affected taxpayers, and similar factors.”

Comparable considerations arise in estoppel situations – see Chapters 27.29 and 28.19 onwards.

27.25 An example; Canada: January 26 1984 Agreement (Article 7)

The issue of retroactivity is illustrated by Canada: January 26 1984 Agreement (Article 7), in which the US and Canadian tax authorities give detailed “rules” on the taxation of offshore drilling rigs located in Canada. This 1984 Agreement has received adequate publicity but, although it is dated the same day as the Canada/US tax treaty

was eventually ratified, it is not referred to in this treaty's text. This omission is surprising – if only because, apparently, this Agreement had originally been reached under the authority of the 1942 tax treaty.

This 1984 Agreement arose in connection with securing the US Senate's approval to the 1980 treaty (and which applies prospectively effective January 1 1985 – see US: Rev. Rul. 85-76 – Article 29). It runs in part (*italics added*): “Upon the entry into force of the Canada-US Income Tax Convention signed September 26, 1980, as amended by a Protocol signed June 14 1983 (the “Proposed Convention”), the Competent Authority agree to *reaffirm* the agreement described herein.”

To what extent should this 1984 Agreement apply to the 1980 tax treaty – and to its 1942 predecessor (under which it had originally been reached)?

27.26 *The 1980 Canada/US tax treaty*

At a public international level, this 1984 Agreement probably binds the US and Canada as between themselves (see Para. 33 of the Commentary on Article 25 of the 1977 OECD Model, discussed in Chapters 27.01 and 27.02).

At a domestic level, the status of this 1984 Agreement is less clear. Under the 1992 ALI Report's Recommendation 4 (see Chapter 27.20) it would be “controlling” as regards the interpretation of any treaty term. US courts might agree with this position. However, Canadian courts might take a different view.

Be that as it may, this 1984 Agreement does much more than *interpret* treaty terms – it provides detailed rules on depreciation, losses, fees, expenses, credits and filing requirements. Should these rules, which govern tax liabilities, also be “conclusive”? Osgood comments (1984, 268) that this Agreement “does not appear to be legislative in character. Rather, it interprets the Conventions' provisions for deductions from business profits by establishing the amount of, and procedure for obtaining, deductions for oil rig depreciation. It is, therefore, consistent with a limited view of the role of mutual agreement proceedings.” Nevertheless, in some circumstances these rules could have the effect of increasing Canadian or US tax.

27.27 *The 1942 Canada/US tax treaty*

This 1984 Agreement provides that the competent authorities have agreed that they “shall be guided” by its principles in applying the 1942 Canada/US tax treaty – a treaty signed nearly 42 years earlier. Should this 1984 Agreement – which apparently reaffirms a prior (unpublished) agreement – apply retroactively?

At a public international level, as between the treaty partner States themselves, this 1984 Agreement should probably govern the interpretation of the 1942 tax treaty.

At a domestic level, however, the position is debatable. Should a distinction be made between this agreement's interpretative and its non-interpretative provisions? Should (any part of) the Agreement apply prospectively i.e. from the date it was made public? Should (any part of) this Agreement apply retroactively to when the original agreement was apparently reached – or, possibly, 1942?

27.28 *Are competent authority agreements on other tax treaties relevant?*

Material which does not involve the treaty at issue can never be conclusive – even if it involves a predecessor tax treaty (see France: *March 14 1979 CE* (Article 4) and Chapters 24.04, 27.29 and 28.08).

In Switzerland: *June 22 1990 Bundesgericht/1* (Article 15) the Swiss tax authorities sought to interpret the 1951 US tax treaty by reference to the “meaning” of terms in the 1971 Germany tax treaty which they and their German counterparts had agreed in their Commentaries. The Bundesgericht held that this was not permissible because the 1951 US tax treaty pre-dated these Commentaries. Furthermore, these Commentaries involved a treaty which had been modelled on the 1963 OECD Draft (see Chapter 26.11) – which this 1951 US treaty also pre-dated.

27.29 *Subsequent competent authority agreements and estoppel*

At a domestic level, bilateral agreements may ostensibly improve taxpayers’ rights – and a taxpayer who has relied in good faith upon such an agreement may reasonably argue that it should govern his case. He may argue that the tax authorities of both States should be estopped from making an assessment which conflicts with their agreement. He may also argue that a bilateral agreement on the meaning of the tax treaty term should be given more weight than a unilateral ruling – because the former expresses the views of both States.

Recommendation 8 of the 1992 ALI Report runs in part (58): “... a taxpayer should be able to rely upon a unilaterally asserted interpretation” by one State in his dealings with that State – see Chapters 21.07 and 28.19. Furthermore, this Report accords great weight to *all* bilaterally asserted interpretations – even subsequent ones (see Chapter 27.20). Accordingly, it must be assumed that this Report’s authors would accept that an estoppel argument applies with even greater force to bilateral agreements.

Estoppel arguments have had some success as regards unilateral rulings – see Chapter 28.19 onwards. There seems no reason why they (or comparable) arguments should not have even greater success as regards bilateral competent authority agreements.

There is material on taxpayers advancing an estoppel argument as regards bilateral agreements, and some examples follow.

In France: *March 14 1979 CE* (Article 4 and see Chapters 24.04 and 28.08) a Joint Commission of governmental delegates from France and Switzerland had found that a lady’s sister (with whom she shared a Swiss apartment) was a resident of Switzerland.

This finding, and a French Ministerial Reply, seemingly influenced Commissaire Rivière’s conclusion that this lady was also resident in Switzerland. Although the Conseil d’Etat’s brief opinion gives no indication that it was also influenced by this material, it also held that this lady was a resident of Switzerland.

Italy: *May 24 1988 CC* (Article 12) held that the Italian tax authorities could renege, to a taxpayer’s disadvantage, on a bilateral competent authority agreement – see Chapter 27.14. However, it is unclear whether the taxpayer advanced an estoppel argument.

Chapter 28 Subsequent unilateral Regulations, Rulings and Procedures

28.01 *The distinction between tax treaty conditions and extra-textual conditions*

Unlike the 1977 and 1992 OECD Models, a tax treaty can expressly make its benefits conditional upon a particular certificate being obtained, or upon a particular procedure being followed. Because such a condition is incorporated into the text of the tax treaty itself, it has the force of law – and failure to meet it will preclude the availability of the treaty's benefits.

Thus, France: December 8 1986 Reply Chartron (Article 11) holds that if the certificate specifically mentioned in Article 10 *bis* of the 1958 Luxembourg tax treaty is not produced, the treaty-reduced 10% withholding tax on interest paid to Luxembourg residents is not available.

28.02 *The distinction between Regulations, Procedures and Rulings*

Again unlike the 1977 and 1992 OECD Models, a tax treaty can (also) give each State authority to issue its own unilateral Regulations “interpreting” this treaty and/or laying down what procedures must be followed if its benefits are to be obtained.

For example, in line with previous US tax treaties, Article 25(5) of the 1977 US Model ran: “The competent authorities of the Contracting States may prescribe regulations to carry out the purposes of this Convention.” However, this provision did not reappear in the 1981 US Model – doubtless because the US Treasury has not issued Regulations for many years.

Such a specific authority permits each State to issue unilateral Regulations (which must be consistent with the purposes of a tax treaty). However, even if a tax treaty does not contain any specific authority to issue regulations, tax authorities remain free to issue their own unilateral explanations of their interpretative positions.

Nevertheless, a distinction must be drawn between material (such as Regulations) issued by tax authorities under an authority in a tax treaty and material (such as Procedures and Rulings) not issued pursuant to any authority in a tax treaty. Whether more weight should be given to Regulations, rather than Procedures and Rulings, depends upon the scope of the specific tax treaty authority under which Regulations are issued and upon constitutional and legal considerations in each State. This issue is very similar to the validity of bilateral competent authority agreements reached under a specific tax treaty authority, an issue discussed extensively in Chapter 27.

To avoid duplication, this Chapter does not discuss these issues any further – apart from analysing jurisprudence in France, Netherlands and the US. This jurisprudence shows that courts in these countries have given considerably more weight to Regulations issued pursuant to an authority in a tax treaty than to Procedures and Rulings not issued pursuant to such an authority.

Perhaps not coincidentally, French and US courts have often also made excessive references to domestic law pursuant to provisions comparable to Article 3(2) of the 1977 and 1992 OECD Models – see Chapters 8.18 and 8.19. Indeed, in US: January 16

1963 *Samann* (Article 25 and see Chapter 28.14), Judge Bryan specifically linked the validity of US Regulations to such a provision – which he described (313 F.2d 463) as “[c]onclusive evidence of the signatories’ desire to retain their own scheme of taxation ...”.

28.03 Subsequent domestic unilateral Rulings

A subsequent unilateral Ruling, which relates solely to one tax treaty, should generally be accorded some weight as regards this treaty.

Furthermore, the numerous Rulings in the US and elsewhere mentioned in Chapters 24.07 and 24.08 evidence that tax authorities generally interpret the same term in different tax treaties consistently – so a ruling on wording in one tax treaty may be equally applicable to comparable wording in another tax treaty. Nevertheless, there are four reasons why subsequent unilateral Rulings issued by tax authorities should not be accorded considerable weight – either at a public international level, or at a domestic level.

Firstly, *subsequent* Rulings cannot, by definition, have been in the mind of those negotiating a tax treaty.

Secondly, *unilateral* Rulings can only represent the current (let alone the past) views of *one* State. Unilateral interpretations can only become bilateral when a State agrees with a treaty partner State’s interpretation. What amounts to an “agreement” will be a matter of evidence – the most acceptable evidence being a subsequent formal bilateral treaty or, failing this, a publicised (see Chapter 21.04) competent authority agreement. In the absence of such an agreement, however, a unilateral interpretation should be accorded no more weight than any other current Government view.

Thirdly, *Rulings* are just that; typically, they have no legal force. Accordingly, they (in common with Procedures) may simply be revoked. For example, US: Rev. Rul. 85-76 (see Chapter 25.07) revoked LR 85-13-038 (Article 29).

Because Rulings and Procedures typically have no legal force, they may also be disregarded by courts – as has happened on many occasions.

For example, Australia: December 18 1987 *Case V9* disregarded IT-100 (which was then withdrawn by IT-2619) – all Article 14. Similarly, February 16 1990 *Case X26*, upheld by June 12 1992 *Robinson*, disregarded Paras. 9 and 10 of the Australian tax authorities’ June 17 1986 IT 2323 (all Article 17).

Canada: March 9 1979 *MacMillan Bloedel* (Article 11) held that the Minister’s position as outlined in a Press Release and an Information Circular had no clear statutory authority, and thus had no basis in law. Under the 1942 US tax treaty, a Canadian resident was therefore entitled to apply the treaty-reduced 15% rate of withholding tax on interest paid to US nominees – even though they were not beneficially entitled to this interest.

French courts can disregard Ministerial Replies (see Chapter 27.07) and US courts can disregard IRS Revenue Procedures (see Chapter 28.17) and Rulings (see Chapter 28.18) – if only because they are not issued pursuant to any authority in a tax treaty.

The above views are largely shared by the 1992 ALI Report's Recommendation 7(c), which provides (55) that weight may be given in appropriate cases to "(c) The unilateral practice of the government agencies charged with the negotiation and enforcement of the treaty".

The 1992 ALI Report comments (56 and 57, footnote omitted): "The Recommendation would substantially limit the weight to be given to subsequently promulgated administrative interpretations which are neither the product of a competent authority agreement nor an interpretation that is clearly followed by the treaty partner as well. Whatever deference to agency interpretation may be appropriate in other treaty contexts, tax treaties should be treated separately. From the point of view of the taxpayer, the rules of the treaty represent the substantive principles under which his tax liability is being determined."

Finally, *tax authorities'* rulings may be self-serving – especially if issued in contemplation of litigation (see Chapters 21.07 and 28.18).

Recognising this, Recommendation 5 of the 1992 ALI Report runs in part (51): "5. In the interpretation of a treaty term, little or no weight should ordinarily be given to ... post-ratification unilateral declarations, including interpretative Revenue Rulings, when they are published in connection with pending or threatened disputes."

28.04 *Subsequent unilateral Rulings in the treaty partner State*

Recognising the need for an internationally consistent approach to tax treaty interpretation, domestic courts have often referred to foreign jurisprudence – see Chapter 29. For similar reasons, subsequent Rulings in a treaty partner State can be most instructive. Thus in Canada: February 19 1992 *Utah Mines* (Article 7 and see Chapter 9.17), Walsh D.J. focused on US: LR 78-44-008 (which he researched by using *The International Tax Treaties Service*) and found it "interesting" – which it is. Although LR 78-44-008 involves two UK/US tax treaties, its (misleading) comments on the impact of changed domestic laws are of global interest – see Chapter 10.05.

In the interests of reciprocity (see Chapter 12), some domestic courts have followed unilateral Rulings by a treaty partner State – even when they post-date a tax treaty.

For example Canada: March 17 1976 *Canadian Pacific* (Article 12) involved an issue in the 1942 US tax treaty which the IRS had expressly ruled upon in US: Rev. Rul. 73-278 (also Article 12). Walsh J. held (76 DTC 6135): "While it is true that this Court has the right to interpret the *Canada-US Tax Convention* and *Protocol* itself and is in no way bound by the interpretation given to it by the US Treasury, the result would be unfortunate if it were interpreted differently in the two countries when this would lead to double taxation. Unless therefore it can be concluded that the interpretation given in the US was manifestly erroneous it is not desirable to reach a different conclusion, and I find no compelling reason for doing so."

This statement by Walsh J. was cited with approval by Grant D.J. (at 79 DTC 5345) in Canada: September 7 1979 *Hunter Douglas* (Article 10). It was also cited in Canada: December 14 1987 *Chhabra* (Article 6) when Cullen J. held (88 DTC 6024 and 6025):

“The same type of reasoning can be applied to this case. The IRS accepted the plaintiff’s figures and calculations relating to US property along with an election under the Tax Convention. The Department of National Revenue, in using unsubstantiated figures and imposing calculations in respect of US property pursuant to Canadian Income Tax rules, had in effect increased taxes payable on the same property in another jurisdiction. I do not think the IRS’ conclusions regarding the figures used by the plaintiff could be considered manifestly erroneous, given the facts outlined by the plaintiff in his submission.” This holding hints at the background to Cullen J.’s (arguably *obiter*) comment that the plaintiff was entitled to compute his US income on US, and not Canadian, principles – see Chapter 8.22.

28.05 *Subsequent unilateral Rulings in third States*

Some domestic courts have even considered subsequent unilateral Rulings in third States, notably when they involve a common treaty partner State.

For example, Netherlands: *March 14 1979 HR* (Article 4) involved the 1971 Spain tax treaty. The Netherlands Attorney-General, who also used *The International Tax Treaties Service* as his reference source (see Chapter 30.02), cited Norway: April 18 1972 Ruling (Article 4) – which interpreted the 1963 Norway/*Spain* treaty.

Even material as exiguous as subsequent pronouncements by third States on tax treaties with other States can be a helpful means of interpretation – if only because this may be the only material focusing on the point at issue. Material confirming the correctness of a particular interpretation may reassure; conflicting material may lead to issues being examined in greater depth than would otherwise have been the case.

In either case, the more such material is considered, the more likely it is that a consistent interpretation will prevail in all States. Accordingly, any interpretation of a term at issue should be considered.

28.06 *France: April 16 1991 Lyon CAA and June 17 1987 CE (both Article 25)*

As indicated in Chapter 28.02, a distinction must be drawn between material issued pursuant to an authority in a tax treaty – and material which is not issued pursuant to any such authority. This distinction is evident in two French decisions involving the 1967 US tax treaty. Article 9(6)(a) of this treaty (as amended by the 1970 Protocol) gives US residents rights to receive an “avoir fiscal” on French source dividends.

In relation to these rights, Article 9(6)(d) runs: “(d) The competent authorities may prescribe regulations to implement the provisions of this paragraph and further define and determine the terms and conditions under which any payment provided for in subparagraph (a) may be made.”

The French tax authorities view Article 9(6)(d) as giving them quasi-legislative powers – see France: March 3 1988 Instruction (Article 25).

This view was confirmed by France: *April 16 1991 Lyon CAA*, in which the plaintiff declared a dividend to two of its shareholders who were resident in the US. However, the Cannes agency of Bank Sudameris France, acting as intermediary, physically paid

the dividend and the avoir fiscal.

Under the French tax authorities' August 4 1972 Instruction, "establishments" (such as banks etc., including Bank Sudameris France) paying dividends could request a refund of any avoir fiscal they paid to US residents. However, the plaintiff was not an "establishment" – so *April 16 1991 Lyon CAA* refused its request for a refund. The CAA held that the Instruction validly precluded the plaintiff from claiming a refund of the avoir fiscal which it was, seemingly, entitled to.

Contrast the validity of this part of the 1972 Instruction (involving dividends and based upon Article 9(6)(d)) with the invalidity of another part of this 1972 Instruction (involving royalties and only based, if at all, on the ostensibly bilateral Mutual Agreement Procedure Article 25 of this same 1967 US tax treaty).

Article 25(2) began: "(2). The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the application of the Convention."

France: *June 17 1987 CE* (Article 25) held that Article 25 did not give the force of law to that part of the 1972 Instruction which (invalidly) made the treaty exemption for royalties conditional upon filing prescribed forms.

The Conseil d'Etat held that the treaty "... did not authorise the Minister to subordinate the tax exemption of French source copyright [royalties] earned by beneficiaries resident in the US to the filing by such persons of a demand stamped either by the American financial establishment, through the intermediary of which these sums were to be cashed, or by the US tax administration."

Accordingly, *June 17 1987 CE* held that a French resident payor of royalties to a US resident was not liable for failing to withhold tax. It made this holding despite the fact that the 1972 Instruction required US residents to file Form 3055 RF 3EU (which had to be pre-stamped by a US financial institution or by the IRS) when requesting an exemption from French withholding tax on royalties paid to them by French residents.

US: July 28 1986 *Casanova* (Article 25) is somewhat comparable – see Chapter 28.16.

28.07 *The distinction in France between Rulings, Instructions, Replies and Opinions*

It has always been accepted that French courts can overrule Rulings, Instructions or Replies emanating from the French tax authorities (or the Ministry of Finance) when this material is not issued pursuant to a specific tax treaty provision comparable to that applicable in France: *April 16 1991 Lyon CAA* (Article 25 – see Chapter 28.06).

For example, a November 21 1985 Instruction was partly overruled by France: *March 24 1992 CC* (Article 2) – see Chapter 24.07.

Similarly, France: February 8 1982 Reply Pericard (emanating from the Ministry of Finance) held that a non-French national could be taxed on a capital gain made on a sale of a French residence, despite the existence of a Non-Discrimination Article in a tax treaty. Reply Pericard was disregarded by *August 3 1988 Nice TA* – to which the French tax authorities acquiesced in June 19 1989 Reply Mesmin. All this material is

analysed in Article 24.

French administrative courts (such as Conseil d'Etat) used to regard themselves as bound by an opinion by the Minister of Foreign Affairs – as the Cour de Cassation also once did (see Lidstone 1962, 535 and 536). This is no longer the case – see Chapter 28.08.

28.08 Opinions of the French Minister of Foreign Affairs

The principle in French *administrative* courts that the Minister of Foreign Affairs was the only person competent to interpret treaties was of long-standing. It was originally laid down in *July 23 1823 CE* (Veuve Murat; Recueil 545) and *August 6 1823 CE* (Le Corsaire “La Représaille”; Recueil 558).

July 3 1931 CE (Karl and Tito Samé; Lebon 722) then held that one consequence of this principle was that any unclear treaty terms had to be referred to the Minister of Foreign Affairs – whose opinion was binding. Such referrals have involved tax treaties – and French courts have long been criticised for their remarkable approach to tax treaty interpretation. As Riedel commented (1951, 35): “Taxpayers of many countries have often vainly tried to have the French Courts initiate an objective and independent method of interpretation in order to take the treaty as an international source of law. It looks like a tragedy when he [Professor Maxime Chrétien] tells us of the series of one-sided, merely by French national concepts inspired case law. So we can understand that especially French lawyers are impatient and eager to set up an international court ...” – see Chapter 2.02.

France: *May 19 1972 CE* (Article 4) involved Article 2(2) of the 1953 Switzerland tax treaty – which gave as a criterion of residence: “the place with which the person’s personal *relations* are closest” (italics added). The Conseil d’Etat found it unclear whether these “relations” were personal and family bonds – or economic and financial links. It referred this issue to the Minister of Foreign Affairs. His opinion, in January 26 1974 Reply Bourgeois (Article 4), was that “relations” meant personal and family bonds. *December 4 1974 CE* (Article 4) then applied this Reply.

In France: *March 14 1979 CE* (Article 4) the same interpretative issue arose in relation to similar wording in the successor 1966 Switzerland tax treaty. The French tax authorities argued that Reply Bourgeois should also apply to this 1966 treaty. As Chapter 24.04 indicates, Commissaire Rivière rejected this argument – on principle. He concluded that the opinion of the Minister of Foreign Affairs on one tax treaty could not bind a court even when it had to interpret similar wording in a successor tax treaty. Nevertheless, he found the 1966 treaty terms “sufficiently clear” for the Conseil d’Etat to refrain from requesting the opinion of the Minister of Foreign Affairs – who would simply give the same Reply.

M. Rivière’s conclusions are not convincing. The reason why he found the 1966 treaty terms “sufficiently clear” was precisely because such clarity had already been brought about by Reply Bourgeois. Had he taken no account of this Reply, these terms would have remained just as unclear as they were when the Minister’s opinion had

originally been requested years earlier. Therefore, M. Rivière effectively applied Reply Bourgeois to a different tax treaty. He pre-empted the Minister of Foreign Affairs – by concluding that the Minister would give the same Reply in relation to a different treaty.

The opinion of the Minister of Foreign Affairs was also sought in France: *March 25 1983 CE* (No. 16.649; analysed in relation to *July 27 1984 CE* – Article 21), which questioned whether withholding tax was due on income deemed distributed abroad by a French company to a Belgian sister company.

The Minister replied that if this income could not be regarded as dividends, the Other Income Article 18 of the 1964 Belgium tax treaty precluded any French tax from being withheld. *July 27 1984 CE* (Article 21) then held that this income was Other Income, exempt from French tax.

There were some derogations to the principle that French administrative courts had to refer to the Minister of Foreign Affairs for his (binding) opinion on the interpretation of (tax) treaty terms.

For example, French administrative courts have long held that when they find (tax) treaty terms to be “clear”, such a reference is not necessary – see, for example, *March 14 1979 CE* (Article 4, criticised above).

The Conseil d’Etat has also shown comparative boldness in finding tax treaty terms “clear” when it has tried to interpret them by reference to domestic law. For example, France: *November 26 1975 CE* (Article 7) held that the meaning of the undefined term “income” should be governed by French domestic law – under which the income of a (Canadian) company from building and selling apartments in France was industrial or commercial profits. Such profits were therefore exempt from French tax in the absence of a French permanent establishment.

The comparative boldness of *November 26 1975 CE* in adopting an independent stance as regards tax treaty interpretation was as welcome as, at the time, it was rare. More the pity that it focused so exclusively on French domestic law, instead of on a possible contextual meaning – see Chapter 8.18.

The Conseil d’Etat has also long held that the meaning of domestic legislation which mirrors treaties can be clarified by *travaux préparatoires* (*October 27 1978 CE*; Section, Debout: Lebon 395).

28.09 French administrative courts can now overrule the Minister of Foreign Affairs

June 29 1990 CE marks so substantial a derogation from the French administrative courts’ long-standing principle of referring tax treaty terms to the Minister of Foreign Affairs that it amounts to a “new approach”.

June 29 1990 CE interpreted manifestly unclear terms in the (non-tax) 1962 Algeria Economic and Financial Co-operation Treaty – without referring them to the Minister of Foreign Affairs. The Conseil d’Etat held that it (and other administrative courts) should, in common with the Cour de Cassation, henceforth reserve unto themselves the power to interpret treaties (including, by implication, tax treaties).

June 29 1990 CE does not exclude the possibility of the Conseil d’Etat requesting the

opinion of the Ministry of Foreign Affairs on the meaning of a tax treaty term. However, any such opinion (requested or not) is merely to serve as a guide.

There are several reasons why *June 29 1990 CE*'s "new approach" was long overdue in a tax treaty context.

Firstly, by accepting the opinion of the Minister of Foreign Affairs, the French administrative courts laid themselves open to the charge that they were effectively accepting the views of the Ministry of Finance (the tax administration) – i.e. a litigant. Although the Minister of Foreign Affairs is responsible for treaties, it never negotiates tax treaties – which are negotiated by officials in the Ministry of Finance. The Ministry of Finance's views may, clearly, influence the opinion of the Minister of Foreign Affairs. The possibility of a self-serving administrative opinion is evident.

Secondly, any court referring tax treaty terms to a Minister is abdicating its judicial responsibility – to an extent which may be unique in a democratic State. Such a stance contrasts with those of other EU Member States' courts, and with that of the European Court of Justice (which considers itself competent to interpret any treaty involving one or more EU Member States). It does nothing to enhance the otherwise excellent reputation of French administrative courts. As Chrétien noted (1951, 59) decades ago, this stance is "indefensible".

Thirdly, a referral procedure wastes time. Administrative courts should be able to give an immediate and consistent interpretation to identical terms in different tax treaties without having to refer to any Minister. Now, however, the procedure should be quicker – because, following *June 29 1990 CE*, the Minister's opinion can be requested before (as well as during) a case. As Commissaire Abraham pointed out in *June 29 1990 CE*, this may result in interpretative opinions being requested more frequently – even though they no longer have their former force.

June 29 1990 CE's "new approach" is likely to fundamentally affect tax treaty interpretation in France. Hitherto, having largely abdicated their responsibility to interpret tax treaties, French administrative courts have not had to consider the relevance of the Vienna Convention. Following *June 29 1990 CE*, they should be far more prepared to interpret "unclear" tax treaty terms. They will have to evolve an interpretative approach to tax treaties – and consider the Vienna Convention. Traditionally, when interpreting domestic statutes, French administrative courts have stressed the importance of the legislature's intention. This approach, which focuses on the "intention" of a single legislature, is at odds with the "textual", "good faith", approach in Article 31(1) of the Vienna Convention – see Chapters 5 and 6. Hopefully, these French courts will now evolve an approach to the interpretation of tax treaties which recognises their unique "dual status" – and the need for them to be interpreted on a consistent basis worldwide (see Chapter 1).

28.10 Netherlands Regulations; November 22 1985 Amsterdam GH (Article 10)

Under the 1964 Law regulating tax matters within the Kingdom of the Netherlands (the "Law", since amended), dividends paid by a Netherlands subsidiary to its

Netherlands Antilles parent could be exempt from withholding tax.

Under the former Netherlands Regulations implementing this Law, a person wishing to pay a dividend free of withholding tax had to apply for – and receive – a favourable decision (beslissing) from a tax inspector. A Netherlands subsidiary did so apply – but a tax inspector refused its application. The subsidiary appealed.

November 22 1985 Amsterdam GH upheld the validity of the Regulations. Because they used the word “decision” (beslissing), and because no appeals were possible from such a “decision”, no appeal against the inspector’s decision was possible. Had the Regulations intended to permit appeals, they would have used the word “decree” (beschikking). (No decisions or decrees are now required under this Law as amended.)

28.11 US Regulations; US: March 23 1954 LMN (Article 25)

Article XXVI(1) of the 1948 Netherlands tax treaty runs: “(1) The authorities of each of the Contracting States, in accordance with the practices of that State, may prescribe the regulations necessary to carry out the provisions of the present Convention.”

The US Regulations provide that a claim on Form 1120 NB (Netherlands) should constitute a refund claim within the meaning of s.322 IRC. Under s.322 IRC, US tax refund claims must be filed within two years from the date US tax is paid.

LMN withheld/paid tax on March 14 1948 – but did not file a refund claim until December 5 1951. The IRS refused to grant the refund, arguing that the s.322 IRC two year refund period had expired.

Smith D.J. held (121 F.Supp. 117): “Taxpayer appears to make two principal arguments, that the provisions of the statute and regulations are inconsistent with the language of the treaty which is paramount, and that they defeat the purposes of the treaty, relief from double taxation and encouragement of economic recovery of the Netherlands.

This second argument is of little weight, for any statute of limitations on refund or recovery of taxes overpaid, so far as it is effective to cut off otherwise just claims, is in derogation of the purpose of the statute or treaty which created the claims. The need for putting an end to a claim period and arriving at a final balance of the results, the difficulties of arriving at just determination of stale disputes, the bases for statutes of repose, outweigh the purposes of original creation of the bases of the claims.

Nor do the regulations appear inconsistent with the language and intent of the treaty. The treaty itself in Article XXVI provides that the authorities of each of the Contracting States, in accordance with the practices of that State, may prescribe regulations necessary to carry out the provisions of the treaty.

Obviously some regulation for handling claims for refund would be necessary where the treaty reduced taxes retroactively.

The requirement of the filing of a return as part of the refund procedure is not unreasonable.”

Smith D.J. continued later (121 F.Supp. 117 and 118): “Is a treaty sufficiently different from a statute so that the contracting parties, under the specific power to make

regulations to carry out the provisions of the treaty, may not put a period to the making of claims for refund?

The treaty itself does not attempt to set rates and methods of collection, refund and administration on the tax on dividends. It merely sets the maximum rate of 15%. It does exempt interest payments received from any tax.

It was however obviously intended not to eliminate or set up a parallel system of collection of the two nations' income taxes, but to continue the existing revenue systems with a limitation for the benefit of the nationals of each on the type of receipts to be subject to the existing tax laws and on the maximum rates so far as dividends were concerned.

It would not appear that a reasonable period of limitation for refund claims under the Treaty is in conflict with the basic purposes of the Treaty, or that the limitations of the Internal Revenue Code are unreasonably short."

28.12 US Regulations; US: March 25 1955 Lewenhaupt (Article 13)

In interpreting the 1939 Sweden tax treaty, *Lewenhaupt* relied upon its US legislative history – see Chapter 25.09, and upon (post-negotiation) US Treasury Regulations issued in 1940 pursuant to its Article XXI.

Article XXI begins: "The competent authorities of the two contracting States may prescribe regulations necessary to interpret and carry out the provisions of this convention."

This tax treaty also contained two conflicting Articles. Article V provided that gains from the sale of real property "shall be taxable only in the contracting State in which the real property is situated." However, Article IX began: "Gains derived in one of the contracting States from the sale ... of capital assets by a resident ... of the other contracting State shall be exempt from taxation in the former State ..."

The US Regulations provided that when a resident of Sweden made a capital gain on a sale of US real property, Article V was to prevail over Article IX.

In line with the Regulations, the Tax Court held that Article V permitted this gain to be taxed in the US – and prevailed over Article IX and its exemption. This holding was confirmed by the Court of Appeals without elaboration.

Harron J. held (20 T.C. 160): "A tax convention or treaty is construed by the courts in the same manner as is a taxing statute. Where there is an inconsistency or conflict in the text of either, a clarifying regulation is not only appropriate but is to be given great weight by the courts. *Koshland v. Helvering*, 298 U.S. 441, 446. And the regulation, if in harmony with the intent and purpose of the statute or tax convention and a reasonable interpretation of its provisions, is to be sustained.

In the instant case, there is a seeming inconsistency or conflict between the provisions of articles V and IX of the tax convention with respect to the treatment to be accorded a capital gain from the sale of real property, which is admittedly a capital asset. We are satisfied, from a review of the commentary on the draft of the tax convention, that the challenged provisions of the regulations are in accord with the

intent and purpose of the convention, and are consistent with its provisions. See, Senate Executive Report No. 18, 76th Cong., 1st Sess. (1939).

The purpose of the tax convention is the avoidance of double taxation. It was not designed, as the petitioner urges here, to exempt a class of income from taxation by both of the contracting states.”

Harron J. continued later (20 T.C. 161): “... a review of the commentary on the proposed draft of the convention convinces us that no substantial change in the treatment for tax purposes by the US of capital gains, whether derived from the sale of real property or from the sale of other capital assets situated in the US by a citizen and resident of Sweden, was intended under the provisions of the convention. In this respect the provisions of articles V and IX of the convention dovetailed into our existing laws. Senate Executive Report, *supra*, pp. 7,8.”

28.13 US Regulations; US: February 21 1962 *de Amodio* (Article 5)

In *de Amodio* Tietjens J. approved (without discussion) US Treasury Regulations, issued pursuant to the 1951 Switzerland tax treaty’s Article XIX (quoted in relation to *Samann* – see Chapter 28.14), and containing the “at any time” rule. Under this rule, a Swiss citizen carrying on a non-Swiss enterprise would be subject to US tax if he “engaged in trade or business within the US *at any time* during the taxable year” (italics added).

28.14 US Regulations; US: January 16 1963 *Samann* (Article 25)

The “at any time” rule was then upheld in *Samann* and September 29 1965 *Simenon* (Article 5 and see Chapter 28.15).

In *Samann*, Circuit Judge Bryan held that Switzerland had tacitly approved of the “at any time” rule because it had not objected to proposed US Regulations (containing this rule) which had been submitted to it. He also held that this rule was known to be the US interpretative position – because the US had made this clear in its Regulations under six tax treaties pre-dating the 1951 Switzerland tax treaty in issue.

Judge Bryan held (313 F.2d 463 and 464 and see Chapter 11.02): “The Convention as a treaty is, of course, “the supreme Law of the Land”. US Constitution, Art. VI, cl. 2; *American Trust Co. v. Smyth* [July 8 1957 *American Trust* – Article 4], 247 F.2d 149, 153 (9 Cir. 1957). Likewise, we start with the additional postulate that the Treasury cannot contract or expand an international compact. ... But the instant regulation, in our judgment, does not impinge, or engraft anything, upon the terms of the Convention. The regulation is but exegetical.

To begin with, the Convention contemplates that “the two contracting States may prescribe regulations necessary to carry into effect the present Convention within the respective States”. Art. XIX. Before their publication by the US, and at the request of the Swiss government, the proposed regulations were submitted to Switzerland. No objection was noted to the one in suit. Thus the Swiss Confederation at least tacitly has approved the presently questioned regulation and has since acquiesced in it. The

conduct of the parties under it is strong avowal of the meaning of their document. *Choctaw Nation of Indians v. US*, 318 U.S. 423, 431-432, 63 S.Ct. 672, 87 L.Ed. 877 (1943); *Factor v. Laubenheimer*, 290 U.S. 276, 294-295, 54 S.Ct. 191, 78 L.Ed. 315 (1933).

No indication is given by the Convention to alter the pattern of income taxation prevailing in either nation. The sole object, to repeat, is to avoid assessment in both countries of the same items of income. Conclusive evidence of the signatories' desire to retain their own scheme of taxation is Article II(2) reading as follows: "In the application of the provisions of the present Convention by one of the contracting States any term not otherwise defined shall, unless the context otherwise requires, have the meaning which such term has under its own tax laws."

"Permanent establishment" is almost a tax treaty word of art. These ententes have been quite common since 1936 – for example, the second French Convention and those of The Netherlands, Denmark, New Zealand, Norway, and Ireland – and nearly all of them use the term. Furthermore, in each instance the phrase has been qualified by a Treasury regulation conforming it to the "at any time" rule – the current usage instead of the negative "at no time". None of the illustrative treaties contains within itself any pertinently corresponding phrase. These agreements all antedate 1951 and their translation by the Treasury in this manner and to this extent has continued uninterruptedly ever since their inception. A regulation of such constancy is staunchly endowed with a presumption of validity ...

... No offence, then, is done our understanding with the Swiss when, with their consent, we endue the terms of the exemption with the meaning they import in the tax language of the US."

28.15 US Regulations; US: September 29 1965 *Simenon* (Article 5)

Article 26 of the 1939 France tax treaty at issue in *Simenon* provided that each of the contracting States "may prescribe regulations necessary to interpret and carry out the provisions of this convention". The US issued such Regulations on February 27 1946 – some time after this treaty's effective date of January 1 1945.

In *Simenon*, Harron J. (who was also the Judge in *Lewenhaupt* – see Chapter 28.12) upheld *Samann*, holding (44 T.C. 840): "It is well settled that a regulation of long standing (such as sec. 514.109 in T.D. 5499, applying the "at any time" rule to the treaty term "permanent establishment"), promulgated by the department charged with the enforcement of the statute, is entitled to great weight and will be followed unless unreasonable or inconsistent with the statute involved. *Commissioner v. Wheeler*, 324 U.S. 542; *Helvering v. Wilshire Oil Co.*, 308 U.S. 90; *Brewster v. Gage*, 280 U.S. 327; and *Lykes v. US*, 343 U.S. 118, 127. It is apparently true (and there is no evidence here to the contrary) that the Government of France has long been acquainted with the respondent's interpretation of the treaty term "permanent establishment" in article 7 of the tax convention, as set forth in section 514.109, T.D. 5499 (the "at any time" rule), and has acquiesced in it as representing a correct interpretation of article 7. Moreover,

substantially the same provisions as are contained in the regulation, sec. 504.109, T.D. 5499, are contained in the general regulations adopted in conjunction with several treaties with other countries relating to the same type of royalty income. See [US: January 16 1963 *Samann* – Article 25 and above] ...”

28.16 US Regulations; US: July 28 1986 *Casanova* (Article 25)

Casanova involved Article XXVI(1) of the 1948 Netherlands tax treaty (as extended to the Netherlands Antilles) which ran: “The authorities of each of the Contracting States, in accordance with the practices of that State, may prescribe regulations necessary to carry out the provisions of the present Convention.”

A US Regulation made this treaty’s benefits involving interest conditional on a Netherlands Antilles payee filing Treasury Form 1001 with the US payor (only).

In *Casanova* Körner J. was more circumspect about the validity of this Regulation than Smith D.J. in US: March 23 1954 *LMN* (Article 25 and see Chapter 28.11).

Körner J. commented (87 T.C. 222 and 223, footnotes omitted): “Respondent’s regulation, section 1.1441-6(c), which we have quoted above, in relevant part, does require the execution and filing with *petitioner* of Form 1001. We give every benefit of the doubt to respondent (as we should in testing the adequacy of petitioner’s motion for summary judgment), and assume for present purposes that the above regulation is a valid interpretive regulation, issued under the authority of section 7805, the Convention, and the Protocol, and that it does not improperly add additional requirements beyond the law, or limit rights which the law provides. It nevertheless appears that respondent requires only that the foreign payee (*Laatam* in this case) furnish a Form 1001 to petitioner as withholding agent, without specifying the time when this should be done. Instead, the regulation provides only “Each such form filed with any withholding agent shall be filed as soon as practicable.” We find this a very vague requirement, and can only infer that respondent was aware that in matters of this sort, involving foreign entities, there might be substantial time delays involved, for any one of a variety of reasons.”

28.17 US Revenue Procedures can be disregarded by US courts

In US: March 17 1988 *Xerox* (Article 23), Futey J. rejected *Xerox*’s assertion that Rev. Proc. 80-18, in its explanation of the US foreign tax credit consequences of an ACT surrender, misconstrued both US law and the terms of the treaty and was therefore “invalid” – see Chapter 27.18.

However, US Revenue Procedures were judged to have no legal force in US: August 25 1982 *Brown & Williamson* (Article 29), US: July 28 1986 *Casanova* (Article 25), and US: August 13 1992 *Snap-On* (Article 23). These decisions are now discussed.

US: August 25 1982 *Brown & Williamson* (Article 29 and see Chapter 12.04) involved Article 28 of the UK 1975 tax treaty, which provided that a reduced rate of withholding tax on dividends was to apply retroactively.

The taxpayer argued that, because it had first made an overpayment of tax in 1975, it

was entitled to interest on the amounts overpaid since that date.

The IRS argued firstly that no interest was due on these overpayments – because US domestic principles on the payment of interest on refunds of retroactive tax reductions were inapplicable when the reduction resulted from a tax treaty, rather than a statute.

The IRS argued secondly that no overpayment occurred until April 25 1980 (the effective date of the treaty). It invoked its own Revenue Procedure (Rev. Proc. 80-18) which ran in part: “Pursuant to Article 28 and for purposes of section 6611, the date of overpayment shall be considered to be April 25, 1980.”

As regards Rev. Proc. 80-18, Chief Judge Friedman held (688 F.2d 752): “This statement merely announced the Service’s position on this issue, and gave no persuasive arguments to support the conclusion. It cannot be fairly read, as the government seeks to do, as distinguishing between retroactive refunds of taxes made pursuant to statute or pursuant to treaty.”

Rev. Rul. 84-133 (Article 29) holds that the IRS will follow *Brown & Williamson*.

As indicated in Chapter 28.16, US: July 28 1986 *Casanova* (Article 25) involved the 1948 Netherlands tax treaty as extended to the Netherlands Antilles.

A US Revenue Procedure, Rev. Proc. 79-40, required *both* Treasury Form 1001 (mentioned in the *Regulation* on the treaty – see Chapter 28.16) and Netherlands Antilles Form VS-4 to be filed with a US payor prior to the time it paid (gross) interest.

However, these two Forms were only filed with the US payor/petitioner some years after it had paid (gross) interest to the payee. The Tax Court nevertheless dismissed the IRS arguments that the US payor should have withheld tax on the interest and that tax treaty relief was unavailable.

As regards Rev. Proc. 79-40, Körner J. held (87 T.C. 223): “... respondent urges that *both* the Treasury Form 1001 and the Netherlands Antilles Form VS-4 must be filed with petitioner as withholding agent *prior to the time the interest in question is paid*. In support of this proposition, respondent relies upon Rev. Proc. 79-40, 1979-2 C.B. 504, which indeed purports to impose such requirements. Such revenue procedures, however, like revenue rulings, do not have the force of law and are merely statements of respondent’s litigating and administrative position. ... We find nothing in the statute, the Convention, the Protocol, or respondent’s regulations which imposes such requirements, either specifically or under any reasonable exegesis of those provisions.”

Körner J. continued (87 T.C. 224, footnote 7 omitted): “It can be urged, no doubt, that the requirements as to documentation and the timing thereof, as mandated by respondent in Rev. Proc. 79-40, are not unduly burdensome upon taxpayers, and are reasonable provisions to assure the orderly and efficient administration of the laws and the protection of the revenues. In the context of the present issue before the Court, however, they go beyond this and have the effect of extending the law, and limiting the substantive rights of taxpayers, beyond that which the treaty provisions and respondent’s regulations require. This is not permissible. If respondent finds his existing regulation inadequate to carry out the administration of the Convention and the

Protocol, he may amend the regulation in a manner not inconsistent with the rights granted under the covenants between the two nations. [Footnote 8 cites Article XXVI(1) of the treaty, quoted in Chapter 28.16.] He may not do so by administrative fiat, nor should he expect this Court to do it for him.

As we have said above, the cross-motions for summary judgment of the parties make it clear that they are in agreement that the two forms here in question are authentic and, in and of themselves, would be sufficient to confer the necessary exemption from withholding upon petitioner. The only dispute here is the matter of timing. On this narrow point, we hold that petitioner's receipt of these documents herein, even though accomplished after the year 1980, was sufficient under the statute, the Convention, the Protocol, and respondent's regulation."

A 1990 Announcement noted that the regulation would be clarified retroactively, and that the IRS acquiesced to *Casanova* – as foreshadowed in LR 87-09-003 (Article 25).

US: August 13 1992 *Snap-On* (Article 23 and see Chapter 25.12) also involved the precedential value (if any) of a Revenue Procedure. Horn J. held (26 Cl.Ct. 1070): "The defendant claims that the Technical Explanation should be followed because it has official IRS backing in Revenue Procedure 80-18, 1980-1 C.B. 623, which was issued to set forth procedures to be followed in applying the US-UK Income Tax Convention. Revenue Procedure 80-18, issued on April 25, 1980, requires taxpayers claiming a refund of ACT tax to apply the Technical Explanation rules. Revenue Procedure 80-18, however, simply announces the IRS position on the issue; it lacks binding precedential value on this court. In *State Bank of Albany v. US*, 209 Ct.Cl. 13, 530 F.2d 1379 (1976), the Court of Claims stated that a revenue ruling "is merely the opinion of a lawyer in the agency and must be accepted as such. It may be helpful in interpreting a statute, but it is not binding on ... the courts." *Id.*, 209 Ct.Cl. at 19, 530 F.2d at 1382 (quoting *Stubbs, Overbeck & Associates v. US*, 445 F.2d 1142, 1146-47 (5th Cir.1971)); see also *Biddle v. Commissioner*, 302 U.S. at 582, 58 S.Ct. at 383."

28.18 US Revenue Rulings can be disregarded by US courts

Just as US courts may disregard IRS Revenue Procedures (see Chapter 28.17), so they may disregard IRS Revenue Rulings. For example, US: August 21 1985 *Crow* overruled US: Rev. Rul. 79-152 (which had held that the standard US savings clause permitted the US to tax some non-resident expatriates) (both Article 1).

In *Crow* Cohen J. held (85 T.C. 389): "Respondent urges us to give deference to "the view of the Treasury Department" expressed in Rev. Rul. 79-152. A revenue ruling represents the view of the Commissioner, not the Treasury Department (*Browne v. Commissioner*, 73 T.C. 723, 731 (1980) (Hall, J., concurring)), and thus is generally only "the contention of one of the parties to the litigation." *Estate of Smead v. Commissioner*, 78 T.C. 43, 47 n. 5 (1982). See *Stubbs, Overbeck & Associates, Inc. v. US*, 445 F.2d 1142, 1146-1147 (5th Cir. 1971); *Estate of Lang v. Commissioner*, 64 T.C. 404, 406-407 (1975), affd. on this issue 613 F.2d 770, 776 (9th Cir. 1980). Because Rev. Rul. 79-152 does not constitute a consistent and long-standing

administrative position with prior congressional or judicial approval, it is not entitled to any special deference in this Court.”

Again, US: April 11 1983 *Burghardt Estate* and December 8 1986 *Mudry* (see Chapter 10.11) disregarded Rev. Rul. 81-303 – which the Judges did not even deign to cite. The Judges’ stance was vindicated by a change in the Code – see Chapter 29.02, and by an IRS acquiescence in Rev. Rul. 90-101 (all Article 3).

Rev. Rul. 79-152 and Rev. Rul. 81-303 both involved tax treaties concluded many years earlier – and were both issued unilaterally by the US tax authorities in anticipation of litigation. As indicated in Chapter 28.03, such subsequent, adversarial, Rulings should be accorded no more weight than any other Government argument – because they may be self-serving.

28.19 Estoppel

Recommendation 8 of the 1992 ALI Report runs in part (58): “... a taxpayer should be able to rely on a unilaterally asserted interpretation” by one State in his dealings with that State – see Chapter 21.07. Unfortunately, however, taxpayers have had mixed success with estoppel arguments – see Chapters 27.29 and 28.20 onwards.

28.20 Unilateral estoppel in Australia

In Australia: December 18 1987 *Case V9* (Article 14), Deputy President R.K. Todd considered that he had no option but to uphold a tax assessment and penalties – even though they arose because the taxpayer relied upon (incorrect) advice provided by the Australian tax authorities.

R.K. Todd complained (88 ATC 152 and 153): “... I find it disturbing indeed that an arm of the Commonwealth Government should: (a) take four years and nine months to produce and provide a copy of a departmental policy (the Ruling) on the precise point involved in the initial query; (b) provide incorrect advice in response to a query knowing that reliance would be placed upon that advice; (c) take two years and eight months to provide correct advice; and (d) then maintain the imposition of penalties against the person who has suffered the consequences of such defective administration.”

R.K. Todd concluded (88 ATC 154): “25. This whole case has had an unfortunate history, which is worsened by the fact that the applicant’s problems arose due to assistance he gave to the Australian people through chairing a public inquiry. It is to be hoped that future visitors to this country do not have the same experience. If they should hear of what happened in this case, they may decide not to come at all.”

28.21 Unilateral estoppel in Canada

In Canada: June 8 1955 *Nisse* (Article 23) the Canadian tax authorities challenged the appellant’s method of declaring US income which they had previously accepted.

R.S.W. Fordham Q.C. upheld their challenge, commenting (55 DTC 360): “Many years ago, someone wrote: “Consistency, thou art a jewel”. Taxpayers suppose, very

reasonably, that what has passed muster in earlier years will be treated likewise thereafter. It often develops, however, that a mistaken method of assessing has been followed in the past and that, the error having been perceived, a new practice is adopted that appears to be more in keeping with the relevant provisions of the Act. That, I think, is what has happened here and what seems like an inconsistency to the appellant, is really an incidental result of correcting a faulty assessing procedure.”

However in Canada: February 3 1972 *Bowen* (Article 14) the Tax Review Board held that the Canadian tax authorities could not renege on their own unilaterally asserted interpretation. Relying upon the Canadian tax authorities’ Information Bulletin 41, Bowen had stayed on in Canada and had jeopardised his “teacher” exemption under Article X of the 1948 New Zealand tax treaty.

The Canadian tax authorities argued (72 DTC 1166): “... the appellant cannot avail himself of the rules contained in Information Bulletin No. 41, even though they were issued by no less a personage than the Deputy Minister of the Department of National Revenue, because the said Deputy Minister does not have the power to legislate nor to interpret legislation for other than his own purposes.”

J.O. Weldon Q.C. held that Bowen was entitled to the Article X exemption. He held (72 DTC 1166): “... I have come firmly to the conclusion that it is not now open to the Minister to plead Article X of the Schedule to the Canada-New Zealand Income Tax Agreement to the exclusion of and without having due regard to Information Bulletin No. 41 which undoubtedly supports the appellant’s position herein.”

However, *Bowen* should be treated with caution. It was distinguished in Canada: March 11 1975 *Shihadeh* (Article 14) when Lucien Cardin Q.C. commented (75 DTC 76): “I do not believe that ... *Bowen* ... has ever been followed by any tribunal.”

28.22 Unilateral estoppel in New Zealand

New Zealand: December 23 1992 *Case Q11* (Article 18) dismissed the Objector’s argument that the NZ tax authorities were estopped from departing from their prior practice of, in effect, deducting his UK social security pension twice.

Barber D.J. held (15 NZTC 5,076): “In accordance with sec 19 of the Act the Commissioner has a duty to make assessments in terms of the Act (*C of IR v VH Farnsworth Ltd* (1984) 6 NZTC 61,770). The Commissioner must act fairly and treat all taxpayers alike (*Reckitt and Colman (New Zealand Ltd) v Taxation Board of Review* [1966] NZLR 1032). In *Lemington Holdings Ltd v C of IR* (No 2) (1983) 6 NZTC 61,576, the High Court stated that the Commissioner must act consistently towards the same taxpayer. However, the Commissioner’s overriding duty was to exact the correct amount of tax. This is an obligation which cannot be fettered by previous assessments against the same taxpayer whether for the same or previous years.

As *Richardson J.* said in *North Island Wholesale Groceries Ltd v Hewin* (1982) 5 NZTC 61,289 at p 61,294: “ ... He [the Commissioner] cannot be estopped by past conduct from performing his statutory obligations in making assessments reflecting his present judgment as to that statutorily imposed liability”.

These concepts are also dealt with in *Europa Oil (NZ) Ltd v CIR (No. 1)* [1970] NZLR 321, *AGH Finance Ltd v C of IR* (1982) 5 NZTC 61,189, and in *Challenge Realty Ltd v C of IR* (1990) 12 NZTC 7,212.”

28.23 Unilateral estoppel in the US

In US: May 11 1981 *Vetco* (Article 26) *Vetco* argued firstly that the US tax authorities could not act in a manner contrary to their own (non-statutory) regulations in an Internal Revenue Manual. *Vetco* argued secondly that, because this Manual provided: “The articles of the respective tax conventions determine the extent of information obtainable in treaty countries”, tax treaty procedures should be the exclusive method of obtaining information. The court did not have to decide *Vetco*’s first argument – because it dismissed its second argument.

In US: June 29 1992 *Hofstetter* (Article 24) Panuthos J. explained the basis for an estoppel argument. He held (98 T.C. 700 and 701): “Petitioner argues that respondent should be estopped from determining a deficiency for 1988. Equitable estoppel is a judicial doctrine that “precludes a party from denying his own acts or representations which induced another to act to his detriment.” *Graff v. Commissioner* 74 T.C. 743, 761 (1980), affd. 673 F.2d 784 (5th Cir. 1982); see also *Kennedy v. US*, 965 F.2d 413 (7th Cir. 1992). Estoppel is applied against the Commissioner “with utmost caution and restraint.” *Estate of Emerson v. Commissioner*, 67 T.C. 612, 617 (1977). Traditional elements of equitable estoppel include: (1) Conduct constituting a representation of material fact; (2) actual or imputed knowledge of such fact by the representor; (3) ignorance of the fact by the representee; (4) actual or imputed expectation by the representor that the representee will act in reliance upon the representation; (5) actual reliance thereon; and (6) detriment on the part of the representee. *Graff v. Commissioner*, *supra* at 761. Detrimental reliance on the part of the party seeking to invoke estoppel is a key condition. *Boulez v. Commissioner*, 76 T.C. 209, 215 (1981), affd. 810 F.2d 209 (D.C. Cir. 1987); *Hudock v. Commissioner*, 65 T.C. 351, 363 (1975). The burden of proof is on the party claiming estoppel against the Government. Rule 142(a); *Estate of Emerson v. Commissioner*, 67 T.C. 612, 618 (1977).”

Panuthos J. held that several of these elements, notably reliance, had not been fulfilled. Accordingly, he dismissed *Hofstetter*’s estoppel (and other) arguments.

Chapter 29 Jurisprudence

29.01 Jurisprudence at a public international level

Article 38(1)(d) of the Statute of the International Court of Justice runs in part (bold added): “The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply: ... (d) subject to the provisions of Article 59, judicial decisions ... of the various nations as subsidiary means for the determination of rules of law.”

Article 59 runs: “The decision of the Court has no binding force except between the parties and in respect of that particular case.”

When a tax treaty term is interpreted at a public international level, account should therefore be taken of all decisions in all nations on identical or similar tax treaty terms.

However, the weight to be given to any decision will depend upon the reputation and status of the court concerned – see Chapters 24.05 and 29.05. Furthermore, decisions pre-dating a tax treaty should normally be accorded greater weight than decisions post-dating a tax treaty – because only the former could have been taken into account by the treaty negotiators (see Chapter 21.05). For the same reason, decisions in the treaty partner States should normally be given greater weight than decisions in other States.

29.02 Local jurisprudence

At a domestic level, comparable considerations apply. As Skaar has commented (1991, 55): “In the absence of an international tax court to settle disputes between states, national judicial rulings between the tax authorities of the states and a taxpayer are an important source of information as to how treaty obligations are applied.”

Decisions in one State will, of course, be given very great weight in that State (where they may, indeed, constitute binding precedent). Even if not binding, a decision may be highly persuasive as regards that tax treaty at issue, and as regards all other tax treaties concluded by that State which contain identical or similar wording. The more similar the tax treaty terms, the more valuable a decision on these terms can be.

Logic and consistency demand that identical or similar wording in tax treaties be interpreted identically or similarly. The need for consistency in interpreting tax treaties is even greater than the need for consistency in interpreting purely domestic laws.

As *Stanford Law Review* commented (1962, 131 and 132): “[In treaty cases] ... unpredictability is even more harmful than in nontreaty cases: first, because the issue in treaty cases is the fundamental *right* to tax, not merely the *amount* of tax, and second, because treaty cases involve matters of foreign relations as well as taxation, while nontreaty cases involve only taxation.”

Sometimes a domestic decision can be so convincing that confirming (rather than reversing) legislation is enacted. Thus, as indicated in Chapters 10.11 and 28.18, US: April 11 1983 *Burghardt Estate* and December 8 1986 *Mudry* disregarded Rev. Rul. 81-303, which was effectively overruled by Rev. Rul. 90-101 (all Article 3). s.5032 of the Technical and Miscellaneous Revenue Act of 1988 (TAMRA) then amended the

Code to conform it with *Burghardt Estate* and *Mudry*.

Courts have often accepted that their earlier decisions on a term in one tax treaty can govern the interpretation of an identical or similar term in other tax treaties. For example, in France: *June 10 1983 CE* (Article 4) Commissaire Bissara, in Conclusions that were followed by the Conseil d'Etat, pointed out that the definition of "centre of interests" in the 1958 Italy tax treaty was identical to that in the 1953 Switzerland tax treaty. He concluded that the reasoning which *December 4 1974 CE* (Article 4) had adopted in relation to the latter treaty – and which *March 14 1979 CE* (Article 4) had then applied in relation to its successor (the 1966 Switzerland tax treaty) – was equally applicable to the 1958 Italy tax treaty. This conclusion was reached despite the cautionary note sounded by Commissaire Rivière in *March 14 1979 CE* on applying rulings on one tax treaty to its successor – see Chapters 24.04 and 28.08.

Recommendation 6(d) of the 1992 ALI Report runs (52 and 53): "In treaty interpretation, substantial weight should ordinarily be given to relevant positions of: ... (d) Decisions of US courts interpreting similar treaty provisions."

Recommendation 6 accords with the practice of US courts – which have often considered US decisions interpreting similar provisions in other tax treaties. For example, US: April 15 1958 *Herbert* (Article 5), February 21 1962 *de Amodio* (Article 5), September 29 1965 *Simenon* (Article 5) and May 27 1980 *Riley* (Article 14) all considered other US tax treaty decisions. US: October 22 1975 *Burbank* (Article 26) even considered a 1913 US Supreme Court decision on an extradition treaty with Italy.

Recommendation 6 also accords with IRS practice; several US Revenue and Letter Rulings hold that US court decisions on terms in one tax treaty govern the meaning of similar terms in other tax treaties. Such material includes LR 80-04-139 (Article 11), LR 80-08-064 (Article 18), LR 80-29-005 (Article 6), LR 83-16-109 (Article 5), LR 87-09-003 (Article 25), LR 89-04-035 (Article 18), Rev. Rul. 90-80 (Article 5) and Rev. Rul. 91-32 (Article 5).

29.03 *Jurisprudence in the treaty partner State*

Because a tax treaty should be applied on a basis which reflects the common intention of both treaty partner States (see Chapter 5), domestic courts should consider any relevant jurisprudence in the treaty partner State.

Recommendation 7(a) of the 1992 ALI Report runs (55): "7. Other materials which may be given weight in appropriate cases include: (a) Decisions of the courts of the treaty partner concerning the interpretation of the treaty ..."

The 1992 ALI Report comments (55 and 56) that such foreign material "may be not only relevant but persuasive as to the meaning of a treaty. The decision of a court of the treaty partner, while not binding on the US in any way, is evidence of how a legal tribunal charged with the task of interpreting the same language reached its conclusion. It may, among other things, illuminate the history of the treaty negotiation from the other country's point of view and explain the interaction of the treaty with the domestic law of that country. [Footnote 168: See, e.g. *Pigeon River Improvement, Slide & Boom*

Co. v. Charles W. Cox, Ltd., 291 U.S. 138 (1934).] All these matters are relevant in attempting to understand the mutual expectations of the treaty partners in entering into the treaty.”

As Recommendation 7(a) recognises, a court in one State cannot be bound by a decision in a treaty partner State (or any other State). Thus, France: *February 10 1965 CE* held that it was not bound by the interpretation given to the 1931 Belgium tax treaty by Belgium: *November 14 1961 CC* (both Article 12).

More recently, UK: February 9 1990 *Commerzbank* and Germany: *October 9 1985 BFH* both, thankfully, declined to follow the approach in US: March 5 1982 *Great West* (all Article 7) – see Chapter 6.05 onwards. These divergent approaches show that a foreign decision may interpret a tax treaty more convincingly than a domestic decision. Just as thankfully, the approach in *Great-West* was then distinguished in US: August 13 1992 *Snap-On* (Article 23 see Chapter 25.12). The fact that *Snap-On* (correctly) distinguished the approach in *Great-West* highlights one reason why courts in one State should not blindly follow foreign decisions (such as *Great-West*): decisions (or their approaches) may be distinguished or overruled at a later date.

29.04 Jurisprudence in third States

Domestic courts have long accepted that tax treaties employ *international* tax language, and that terms therein may have no exact counterpart in States' domestic tax laws – see Chapter 7.02. International tax treaty language should therefore be interpreted in the light of the international tax treaty jurisprudence in different nations. Jurisprudence in third States (i.e. in States other than the treaty partner State) may be far more helpful than domestic material, or a treaty partner State's material – neither of which may even exist. Third State jurisprudence may even be persuasive.

Tax treaties can only be applied on a consistent basis worldwide if they are interpreted in the light of international jurisprudence. As Doernberg *et al.* comment (1989 Chapter 1, 30): "... within the boundary of reasonableness, foreign authority should be consulted in interpreting treaties to make treaty application as uniform as possible." Accordingly, just as the International Court of Justice must consider decisions in all "the various nations" (see Chapter 29.01), so domestic courts should consider decisions in all foreign nations on the meaning of *international* tax treaty language.

These simple principles, pioneered by *The International Tax Treaties Service*, are now accepted worldwide.

For example, Resolution 2 on Subject I *Interpretation of double taxation conventions* at the 1993 IFA Congress begins: "To advance the consistent interpretation and application of tax conventions, revenue authorities and courts of a contracting state should consider judicial and arbitral decisions and official revenue authority explanations, regulations and rulings, not only of the other contracting state, but also of third states when such material involves the interpretation or application of identical or substantially similar provisions of a tax convention, especially when they are derived

from the same Model.”

Similarly, Recommendation 7(b) of the 1992 ALI Report runs (55): “7. Other materials which may be given weight in appropriate cases include: ... b) Decisions of the courts of other countries interpreting similar treaty provisions ...”

The 1992 ALI Report accepts (55) that “these may be not only relevant but persuasive as to the meaning of a treaty.” However, it comments (56) that such third State jurisprudence “should be taken into account only in relatively narrow circumstances.” It advances two debatable reasons for this comment.

Its first reason is that treaty negotiators cannot be expected to be aware of every decision worldwide. This ignores the role of *The International Tax Treaties Service* – subscribed to by tax authorities, practitioners and libraries all over the world.

Whilst there is always room for improvement, this *Service* attempts to analyse every significant decision (and ruling) worldwide – and has made awareness of worldwide tax treaty jurisprudence possible for the first time. Some commentators have been kind enough to acknowledge the usefulness of *The International Tax Treaties Service* – see, for example, Boidman (1980), Derouin (1979, 408), Vogel (1979, 86), Baker (1991, Introduction v and vi and 1994, Introduction xi and 45, footnote 34), Maisto (1993, 289, Footnote 12) and Prebble (1993, 481).

The 1992 ALI Report’s second reason (56) why foreign jurisprudence should be taken into account only in relatively narrow circumstances is that it is not “conducive to the expeditious and orderly resolution of interpretative questions to encourage reference to and analysis of a wide range of legal opinions, some of them perhaps the product of legal systems quite different from that of the US.”

Unsurprisingly therefore, and regrettably, the 1992 ALI Report itself hardly considers public international and non-US jurisprudence.

It would be unfortunate if parochialism discouraged others from taking account of international and foreign jurisprudence – for two reasons. Firstly, if *The International Tax Treaties Service* is used, the research involved in ascertaining whether relevant foreign jurisprudence exists is comparatively expeditious and orderly. Secondly, and more fundamentally, no legal system has a monopoly of legal wisdom – so comparisons can be very useful. Foreign tax treaty jurisprudence may be invaluable – if only to confirm a conclusion that has already been reached.

Baker notes (1991, Introduction v): “Certainly, the experience of court decisions on tax treaties (especially in England) is that judges should be grateful for some guidance by seeing how a particular issue has been approached in other countries.” Baker also comments (1994, 40 and 41): “Where the courts or authorities of another state have analysed and discussed the meaning of a particular provision, it would be not simply a chauvinistic judge or official, but a foolish one who failed to pay at least some regard to the results of this analysis and discussion.”

29.05 UK courts must consider foreign jurisprudence – but need not follow it

Some domestic courts interpreting non-treaty laws have long accepted that decisions

in other States may be relevant. For example, as Chapter 3.11 onwards illustrates, courts which have historically applied English common law, such as those in Australia, Bermuda, Canada, Jersey, Guernsey, the Isle of Man, Hong Kong, New Zealand, Rhodesia (now Zimbabwe), South Africa, Singapore and the UK will typically recognise the (possibly persuasive) value of jurisprudence in these comparable jurisdictions.

Furthermore, as Chapter 3.11 onwards also illustrates, the UK House of Lords has made it quite clear that UK courts must consider foreign decisions (and other material) on the interpretation of international commercial treaties. This practice is now routine.

Nevertheless, the House of Lords has made it equally clear that the UK courts must not blindly follow all foreign jurisprudence.

For example, in *Buchanan* (see Chapter 3.12) Lord Wilberforce commented ([1978] A.C. 153): "... the assumed and often repeated generalisation that English methods are narrow, technical and literal, whereas continental methods are broad, generous and sensible, seems to me insecure at least as regards interpretation of international conventions. ... This (CMR) Convention has been accepted by more than 20 states some of them close to English ways of thought. I cannot credit them all, or some average of them, with recognisably superior, or even different, methods of interpretation. We should of course try to harmonise interpretation but, as Megaw L.J. pungently shows (*Ulster-Swift Ltd. v. Taunton Meat Haulage Ltd.* [1977] 1 W.L.R. 625, 631) on this very Convention, courts in six member countries have produced 12 different interpretations of particular provisions – so uniformity is not to be reached by that road. To base our interpretation of this Convention on some assumed, and unproved, interpretation which other courts are to be supposed likely to adopt is speculative as well as masochistic."

Lord Wilberforce noted that whilst a Paris decision favoured one interpretation, a later Amsterdam decision favoured an opposite interpretation. He commented ([1978] A.C. 154): "These cases show that there is no universal wisdom available across the Channel upon which our insular minds can draw. We must use our own methods following Lord Macmillan's prescription [in *Stag Line* – see above] and taking such help as existing decisions give us."

In *Fothergill* (see Chapter 3.13) Lord Diplock noted ([1981] A.C. 284): "As respects decisions of foreign courts, the persuasive value of a particular court's decision must depend upon its reputation and its status, the extent to which its decisions are binding upon courts of co-ordinate and inferior jurisdiction in its own country and the coverage of the national law reporting system. For instance your Lordships would not be fostering uniformity of interpretation of the Convention if you were to depart from the prima facie view which you had yourselves formed as to its meaning in order to avoid conflict with a decision of a French court of appeal that would not be binding upon other courts in France, that might be inconsistent with an unreported decision of some other French court of appeal and [that] would be liable to be superseded by a subsequent decision of the Court of Cassation that *would* have binding effect upon

lower courts in France. It is no criticism of the contents of the judgments in those foreign cases to which your Lordships have been referred if I say that the courts by which they were delivered do not appear to me to satisfy the criteria which would satisfy your Lordships in being influenced to follow their decisions in the interests of uniformity of interpretation.”

29.06 Domestic courts consider foreign (tax treaty) jurisprudence

Recognising that the international tax language in which tax treaties are expressed can only be interpreted satisfactorily if it is interpreted in the light of international tax treaty jurisprudence, courts are focusing on such material with increasing frequency – as indicated below.

My extensive research into tax treaty jurisprudence has convinced me that the quality of a tax treaty decision is invariably enhanced, rather than diminished, when foreign tax treaty jurisprudence (and other material) is taken into account. Tax treaty decisions which cite such foreign material tend to be of a much higher quality than those which do not. This is evidenced by the fact that those tax treaty decisions which do cite such foreign material are *themselves* subsequently cited as authority more often than decisions which ignore relevant foreign material.

As Lord Scarman observed ([1981] A.C. 294) in *Fothergill* (see Chapter 3.13): “... our judges should be able to have recourse to the same aids of interpretation as their brother judges in the other contracting States. The mischief of any other view is illustrated by the instant case. To deny them this assistance would be a damaging blow to the unification of the rules which was the object of signing and then enacting the Convention. Moreover, the ability of our judges to fulfil the purpose of the enactment would be restricted, and the persuasive authority of their judgments in the jurisdictions of the other contracting states would be diminished.”

Furthermore, I have not come across one tax treaty decision which has suffered from reviewing foreign jurisprudence and other material. In contrast, some decisions could have been improved had they considered such material. For example, had Netherlands: *January 30 1990 The Hague GH* considered Canada: *September 7 1979 Hunter Douglas* it should have come to the correct decision eventually reached by Netherlands: *September 2 1992 HR* (all Article 10) – see Chapter 26.01.

References to foreign tax treaty jurisprudence and other material should therefore be encouraged – not discouraged. It would be unwise to underestimate the role that internationally-minded Judges can play in this area – or the resulting value of their jurisprudence. For example, the 1992 ALI Report’s criticism of the approach in US: *May 5 1982 Great-West* first appeared in 1991; by this time, however, this approach had already been rejected in UK: *February 9 1990 Commerzbank* (both Article 7) – see Chapters 6.05 and 29.15.

29.07 Australia considers foreign (tax treaty) jurisprudence

In September 20 1977 *Sherritt Gordon* (Article 12) *McInerney J.* cited (76 ATC

4,139) Ceylon: April 29 1970 *Woodend* (Article 24) and UK: March 2 1961 *Collco* (Article 10) – as did Canada: September 30 1982 *Melford* (Article 7 and see Chapters 10.08 and 29.08).

In August 22 1990 *Thiel* (Article 7 and see Chapter 8.16) a Swiss resident invoked South Africa: August 19 1975 *Downing* (Article 5) in his successful argument that he was not taxable on profits made on sales of Australian shares.

In the Western Australian Supreme Court, Franklyn J. commented (88 ATC 4,110 and 4,111): “I find no assistance from the South African decisions of *Downing v. Secretary for Inland Revenue* 1972 (unreported) or *Secretary for Inland Revenue v. Downing* (1975) (4) S.A. 518 relied upon by the appellant in support of his submission ...” The reason why Franklyn J. found *Downing* to be of no assistance is explicable: his analysis of *Downing* is of questionable accuracy, as *The International Tax Treaties Service* points out.

In the Full High Court, Dawson J. (90 ATC 4,724) and McHugh J. (90 ATC 4,729) both considered Canada: July 19 1972 *Tara* (Article 5) which is itself notable for considering numerous foreign non-treaty decisions – see Chapter 29.08.

Thiel was then considered in New Zealand: February 7 1992 *Wise* (Article 15 and see Chapter 29.12).

Thiel also approved of Lord Radcliffe’s comment in UK: July 16 1959 *Ostime* that a tax treaty employs “international tax language” (see Chapter 7.02) – as did June 11 1993 *Case 23/93* (Article 5; at 93 ATC 296).

Case 23/93 also considered UK: March 12 1968 *London Produce*, again in common with *Thiel*, and South Africa: August 19 1975 *Downing* (all Article 5). B.J. McMahon approved (93 ATC 295) of Megarry J’s description of a general commission agent in *London Produce*, but distinguished *Downing* on the facts. He commented (93 ATC 296): “I welcome the experience of other minds who have had occasion to consider similar problems in this area.”

29.08 Canada considers foreign (tax treaty) jurisprudence

In June 3 1959 *No. 630* (Article 5) the issue was whether a US partner in a Canadian partnership had a permanent establishment in Canada. R.S.W. Fordham Q.C. held (59 DTC 303): “There is a dearth of authority – if any be needed – in the reported cases on the subject in Canada, but there is a recent American decision, which, while not authoritative in this country, of course, is nevertheless persuasive. It is ... [US: August 23 1955 *Johnston* – Article 5] ...”

R.S.W. Fordham Q.C. followed *Johnston* – and held that the US partner had a permanent establishment in Canada. As regards the meaning of the word “permanent”, he held (59 DTC 302): “... the word “permanent” deserves more than just passing notice. It does not necessarily mean permanent in the sense that word is often used. The question was considered in *Henriksen v. Grafton Hotel, Ltd.* (1942) 2 K.B. 184, at p. 196. In that matter, also an income tax case, *du Parcq, L.J.*, of the Court of Appeal in England, said that “permanent” was a relative term and not synonymous with

“everlasting”. That, I rather think, is the meaning intended by its use in the Protocol.”

R.S.W. Fordham Q.C. also considered the Australian non-treaty decision of *F.C. of T. v. Austin* (1932) 48 C.L.R. 590 (at 601-2).

No. 630 and *Johnston* were both cited in US: April 2 1962 *Donroy* (Article 5 and see Chapter 29.16) when Hamlin C.J. noted (301 F.2d 208, footnote 10): “Inasmuch as the phrase “permanent establishment” appears in the Canadian Tax Convention, which is applicable to both Canada and the US, it would be a desirable, although not necessary, result if the courts of each country gave it the same meaning. The decision of the Canadian Tax Appeal Board in *No. 630 v. MNR*, supra, and the decision of the US Tax Court in *W.C. Johnston*, supra, indicate that this has been done.”

No. 630 was also cited in New Zealand: August 17 1965 *Case 5* (Article 5 and see Chapter 29.12), when the Canadian Judge’s reliance upon the UK decision of *Henriksen* was specifically approved, and in US: June 28 1991 *Unger* (Article 5 and see Chapter 29.16).

In June 19 1972 *Tara* (Article 5) one issue was whether the appellant *Tara* (a Canadian corporation) was resident in Ireland under Canadian domestic law and/or under Article II(1)(e) of the 1954 Ireland tax treaty. Canadian domestic law determined residence according to the location of *Tara*’s central management and control.

Jackett P. held (70 DTC 6373): “... I find as a fact that, during the taxation years in question, “the central management and control” of the appellant was in Ireland and was not in Canada.” Because *Tara* was found to be resident in Ireland under Canadian domestic law, the issue of whether it was resident in Ireland under the tax treaty was never reached. However, Jackett P.’s finding could just as well have been made in relation to this treaty – because both it and Canadian domestic law use comparable criteria to determine corporate residence. Thus, according to this treaty’s Article II(1)(e), “a company shall be regarded as resident in Ireland if its business is managed and controlled in Ireland ...”

In making his finding, Jackett P. considered the leading Australian and UK decisions (not involving tax treaties) on corporate residence under domestic law. Jackett P. noted (70 DTC 6373, in a footnote): “I have not overlooked *Swedish Central Railway Co. Ltd. v. Thompson*, (1952) A.C. 495, but I have accepted the law as discussed in *Union Corporation, Ltd. v. Inland Revenue Commissioners*, (1952) 1 All E.R. 646, by Evershed, M.R. (delivering the judgment of the Court of Appeal) at pages 656 *et seq.* (which decision was upheld by the House of Lords on another point in (1953) A.C. 482), and in *Unit Construction Co. Ltd. v. Bullock*, (1960) A.C. 351, by Lord Radcliffe at pages 365 *et seq.*, concurred in by Viscount Simonds at page 363, and by Lord Goddard (page 371). In particular, I have accepted as sound the opinion that “a finding that a company is a resident of more than one country ought not to be made unless the control of the general affairs of the company is not centred in one country but is divided or distributed among two or more countries.” See the dictum of Dixon, J. in *Koitaki Para Rubber Estates, Ltd. v. Federal Commissioner of Taxation*, 64 C.L.R. 15, at page 19, which was adopted by Evershed, M.R. in the *Union Corporation* case,

supra, at pages 657-58.”

Tara was considered in the Full High Court in Australia: August 22 1990 *Thiel* (Article 7) – see Chapter 29.07.

In April 23 1981 *Bank of Nova Scotia* (Article 23) Heald J. found that the only helpful authority as to the correct exchange rate to be used in calculating foreign tax credits was a decision of the English High Court. Heald J. commented (81 DTC 5118 and 5119): “Both counsel submitted a number of authorities in support of their position but I do not find those authorities to be directly applicable to the issue to be decided here. There is, however, one English case to which we were referred that I find helpful to some extent, namely the case of ... [UK: July 6 1956 *Ashton* – Article 23] ...”.

In September 30 1982 *Melford* (Article 7) Estey J. (delivering the opinion of the Supreme Court) considered (82 DTC 6286 and 6287) Ceylon: April 29 1970 *Woodend* (Article 24) and UK: March 2 1961 *Collco* (Article 10) – as did Australia: September 20 1977 *Sherritt Gordon* (Article 12 and see Chapters 10.03 and 29.07).

In Canada: January 28 1985 *Gladden Estate* (Article 13 and see Chapter 24.01) when Addy J. approved (85 DTC 5191) of Chairman Fordham’s statement in Canada: November 30 1954 *Saunders* (Article 19 and see Chapter 11.03) that a “liberal interpretation” was usual in the case of tax treaties, he noted (probably incorrectly – see Chapter 6.06) that a similar approach had been adopted in US: May 5 1982 *Great-West* (Article 7).

In February 13 1985 *Taran Furs* (Article 7 and see Chapters 8.09 and 26.01) Tremblay T.C.J. used the High Court of Australia’s words in the non-treaty decision of *Studebaker Corp. and Commissioner of Taxation for New South Wales* (29 CLR 225 at 232 and 233). He held (85 DTC 202) that interest for late payment “is part and parcel of the one business transaction. The obligation to pay and the right to receive interest flowed from the agreement” (to sell and purchase) made in Copenhagen, Denmark. Accordingly, the source of this interest was Copenhagen.

In November 25 1985 *Fiebert* (Article 5) the Canadian tax authorities relied upon US: April 10 1959 *Consolidated Premium* (Article 5) in arguing that Fiebert’s New York apartment did not constitute a US permanent establishment of an Ontario company (White). Citing *Consolidated Premium*, Brulé T.C.J. held (86 DTC 1017 and 1018): “At [57 DTC] page 1162 there is the following paragraph in the judgment: “The term “permanent establishment” normally interpreted suggests something more substantial than a license, a letterhead and isolated activities. It implies the existence of an office, staffed and capable of carrying on the day-to-day business of a corporation and its use for such purpose, or it suggests the existence of a plant or facilities equipped to carry on the ordinary routine of such business activity. The descriptive word “permanent” in the characterization, “permanent establishment” is vital in analyzing the treaty provisions. It is the antithesis of temporary or tentative. It indicates permanence and stability.”

In the subject case these characteristics were not present thus allowing this Court to reach the conclusion that in the years under appeal White did not have an office in New

York.”

In common with *Taran Furs*, March 3 1989 *Shere* (Article 21) also involved the source of income. Where was the source of remuneration paid in Canadian dollars in Canada by a Canadian employer to an employee working in New York?

Because there was no Canadian jurisprudence on this issue, Couture C.J.T.C. referred (89 DTC 204-206) to various foreign non-treaty decisions. He distinguished *Foulsham v. Pickles* (UK House of Lords; [1925] A.C. 458) and *Bennet v. Marshall* (UK Court of Appeal; [1938] 1 A.E.R. 93) – which both focused on where an employment contract was entered into and where an employee was paid. He preferred the Australian Supreme Court’s approach in *Commissioner of Taxation (N.S.W.) v. Cam and Sons Ltd.* (4 ATD 32) – which focused on where duties were performed.

Couture C.J.T.C. also derived support (89 DTC 206) from US: January 17 1985 *Metz* (Article 20) which involved the 1954 Germany tax treaty.

In October 23 1991 *Hinkley* (Article 15) Lamarre Proulx T.C.J. cited (91 DTC 1338) UK: June 12 1986 *Sun Life* (Article 7, which itself cited *Fothergill* – see Chapter 3.13) as authority permitting him to refer to existing OECD Commentary – see Chapter 23.25.

In February 19 1992 *Utah Mines* (Article 7) Walsh D.J. in the Tax Court referred (91 DTC 5250) to US: January 17 1955 *Handfield* (Article 5). *Handfield* had been cited by the Canadian tax authorities, who also referred to the US Senate Foreign Relations Committee Report on the 1942 US tax treaty at issue – see Chapter 25.13.

29.09 Germany considers foreign (tax treaty) jurisprudence

February 20 1979 *BFH* cited Switzerland: December 23 1970 *Bundesgericht* (both Article 26).

In October 9 1985 *BFH* (Article 7 and Chapters 6.05 and 27.13) the German Federal Ministry of Finance argued that its interpretation of the tax treaty was consistent both with its practice, and with the practice of the US IRS and the UK Revenue. It also noted that the IRS interpretation had been upheld by US: May 5 1982 *Great-West* (Article 7) in relation to the 1942 Canada tax treaty.

The *BFH* held that the ordinary meaning of the tax treaty words did not correspond with the interpretation adopted by *Great-West* (or the three tax authorities). A comparable conclusion was then reached in UK: February 9 1990 *Commerzbank* (Article 7 and see Chapters 6.05, 27.17 and 29.15). Later, a conflicting conclusion was reached by Germany: January 20 1993 *BFH* (Article 7 and see Chapter 6.05) – which did not refer to *Commerzbank*.

29.10 India considers foreign (tax treaty) jurisprudence

In June 17 1983 *Visakhapatnam* (Article 5) the Andhra Pradesh High Court cited UK: July 16 1959 *Ostime* (Article 7 and see Chapter 7.02). It held (per Jagannadha Rao J., 144 ITR 161): “The word “permanent establishment” is one of those technical expressions which is invariably used in all international Double Taxation Avoidance

Agreements as these are based on standard O.E.C.D. models.

In view of the standard O.E.C.D. models which are being used in various countries, a new area of genuine “international tax law” is now in the process of developing. Any person interpreting a tax treaty must now consider decisions and rulings worldwide relating to similar treaties: [Halpern 1978, 394, reviewing *The International Tax Treaties Service*]. The maintenance of uniformity in the interpretation of a rule after its international adaption [sic] is just as important as the initial removal of divergencies (Per Scott L.J., in *Eurymedon* [1938] 1 All ER 122 (CA)). Therefore, the judgments rendered by courts in other countries or rulings given by other tax authorities would be relevant.”

Citing *The International Tax Treaties Service* and material therein namely Belgium: *October 22 1963 CC*, Switzerland: *September 17 1977 Bundesgericht* and US: Rev. Rul. 72-418 (all Article 5), and other authorities, the Judge concluded that a German company had no “permanent establishment” in India.

29.11 The Netherlands considers foreign (tax treaty) jurisprudence

March 14 1979 HR (Article 4) involved the meaning of “centre of vital interests” in the 1971 Spain tax treaty. The Netherlands Advocate-General considered Para. 15 of the 1977 OECD Commentary on Article 14 (an addition proposed in the 1974 Revised Draft) and several Netherlands decisions analysed in *The International Tax Treaties Service*. Citing this *Service* as his reference source, the Advocate-General then considered foreign material on tax treaties, namely France: *March 5 1971 CE* and *December 4 1974 CE*; Germany: *July 23 1971 BFH* and Norway: *April 18 1972 Ruling* (all Article 4).

29.12 New Zealand considers foreign (tax treaty) jurisprudence

Several New Zealand decisions involving tax treaties have considered foreign court decisions. In August 17 1965 *Case 5* (Article 5) the Board specifically approved (3 NZTBR 57) Canada: June 3 1959 *No. 630* (Article 5 and see Chapter 29.08), particularly its reliance upon the UK non-treaty decision of *Henriksen*.

In July 16 1973 *UDT* (Article 24 and see Chapter 3.07) White J. in the Court of Appeal cited two leading UK House of Lords decisions, one of which involved a tax treaty. He commented (1 NZTC 61,037): “Mr. Richardson ... [Counsel for the Commissioner] ... referred to the principles of interpretation applicable in considering the Agreement. It was not suggested that there should be a departure from domestic canons of construction but that it was essential to consider the Agreement having regard to accepted principles of treaty interpretation when such an agreement was “scheduled” and not “paraphrased” as a part of the domestic legislation. Having regard to the statements of Lord *Radcliffe* and Lord *Denning* in the House of Lords in ... [July 16 1959 *Ostime* – Article 7 and see Chapter 7.02] ... (1960) A.C. 459, 480, 484 where double tax agreements were under consideration, Mr. Richardson submitted that the Agreement should be treated as one of a network of international agreements using

international tax language and substantially similar in form and effect. Mr. Patterson [Counsel for UDT] did not accept this, claiming that there was “remarkable diversity” in the so-called “network” of agreements and that the Agreement in the present case was very different from the model agreement in the Draft Convention which, with the commentary, was produced by consent. Mr. Patterson agreed, however, that the concept of “broad principles of general acceptance”, quoted from the judgment of Lord Macmillan in *Stag Line Ltd. v. Foscolo, Mango & Co. Ltd.* (1932) A.C. 328, 350 [see Chapter 3.10], should be applied in considering double tax agreements. There was in fact no dispute between Counsel that the pattern of similar international agreements and cases in which they have been applied are relevant but it was not suggested that any clear trend of authority or practice could be relied on as a precedent at present.”

White J. then drew “support” (1 NZTC 61,039) from Germany: *January 13 1970 BFH* (Article 24) involving a 1959 tax treaty (between France and Germany, two civil law States) which contained a provision similar to Article XIX(1) of the 1966 tax treaty at issue (between NZ and the UK, two common law States).

White J. held (1 NZTC 61,039): “The facts were different from the facts in the present case but the conclusions and reasons are helpful in understanding the nature of a provision similar to Art. XIX(1).”

New Zealand: June 14 1990 *JFP Energy* (Article 15) accorded weight to a unilateral statement by the treaty partner State’s officials (see Chapter 25.13) and should have considered Germany: *February 24 1988 BFH* (Article 15). According to Prebble (1993, 481): “This [German] case was not cited to the New Zealand court, probably because it did not appear in Edwardes-Ker, *The International Tax Treaties Service* (which was used by counsel in the case), until October 1990. ... The 1988 German case would certainly have been influential had the court been aware of it, though one cannot say whether it would have been decisive.”

In New Zealand: February 7 1992 *Wise* (Article 15) Neazor J. considered (14 NZTC 9,040 and 9,041) Australia: August 22 1990 *Thiel* (see Chapter 29.07).

29.13 Rhodesia considers foreign (tax treaty) jurisprudence

In Rhodesia: August 12 1966 *Tetra Pak* (Article 7) Beadle J. cited (28 SATC 215) UK: July 16 1959 *Ostime* (also Article 7) – see Chapter 7.02.

29.14 South Africa considers foreign (tax treaty) jurisprudence

In South Africa: August 19 1975 *Downing* (Article 5) Corbett J.A. also cited (37 SATC 256) UK: July 16 1959 *Ostime* (Article 7) – see Chapter 7.02.

In South Africa: March 10 1992 *ITC 1544* (Article 24) Melamet J. cited (54 SATC 460) *Downing*, *Ostime* and UK: March 2 1961 *Collco* (Article 10).

29.15 The UK considers foreign (tax treaty) jurisprudence

In UK: February 9 1990 *Commerzbank* (Article 7) the Revenue invoked two sources in support of its argument as to the meaning of the 1945 US tax treaty.

The first source was a 1977 joint statement by the US Internal Revenue Service and the UK Board of Inland Revenue, namely US: January 12 1977 News Release (Article 7) – see Chapter 27.17.

The second source was US: May 5 1982 *Great-West* (Article 7 and see Chapter 6.05).

Mummery J. held ([1990] STC 302) that *Great-West*: "... is of some interest as illustrating the basis on which the US taxes foreign corporations trading in the US, but it is of no real assistance in these cases because it is clear from the report that different principles were applied by the court to the interpretation of that convention than an English court would have applied in accordance with the decision of the House of Lords in *Fothergill v Monarch Airlines Ltd* [see Chapter 3.13]. It is stated in the report (at 82-1326) that "... the case law is clear that the meaning given a treaty by an appropriate government and government agency is of great weight". The court was greatly influenced in its decision by the fact that the Departments of State and Treasury interpreted art XII of the Canadian Convention as not conferring the exemption claimed and had negotiated other treaties on that basis. As appears from the decision in *Fothergill v Monarch Airlines Ltd* no such principle is applied by the English courts to the provisions of a convention which had been incorporated into municipal law by primary or secondary legislation. I do not, therefore, find the decision in *The Great West Life Assurance* case of much assistance in the present cases."

Later, Mummery J. commented ([1990] STC 304) that references to US tax law at the time of the 1945 US tax treaty, *Great-West* and the joint statement "do not fall within the description of material to which recourse may be had as an aid to interpretation in accordance with the decision of the House of Lords in *Fothergill v Monarch Airlines Ltd*". This comment should, however, be regarded as more indicative of Mummery J.'s disapproval of the approach in *Great-West* (with its excessive reliance on unilateral US extra-textual post-ratification materials – see Chapter 25.09) than as disapproval of the growing tendency of UK courts to consider foreign jurisprudence (see Chapter 3.11 onwards and Chapter 29.05).

Needless to say, Mummery J. *did* consider foreign jurisprudence (*Great-West*) – and distanced himself from it. He may also have been fortified in his conclusion by Germany: *October 9 1985 BFH* which I understand Counsel referred to – but he did not cite this decision, which was subsequently overruled by *January 20 1993 BFH* (both Article 7 and see Chapters 6.05 and 29.09).

Furthermore, when Mummery J. outlined the principles of treaty interpretation applicable by English courts (see Chapter 3.14), he expressly permitted the (discretionary) consideration of foreign jurisprudence and doctrine. Referring to the speeches in the House of Lords in *Fothergill* (see Chapter 3.13), his fifth and sixth principles are ([1990] STC 298):

"(5) Subsequent commentaries on a convention or treaty have persuasive value only, depending on the cogency of their reasoning. Similarly, decisions of foreign courts on the interpretation of a convention or treaty text depend for their authority on the reputation and status of the court in question: per Lord Diplock (at 283 - 284) and per

Lord Scarman (at 295).

(6) Aids to the interpretation of a treaty such as travaux préparatoires, international case law and the writings of jurists are not a substitute for study of the terms of the convention. Their use is discretionary, not mandatory, depending, for example, on the relevance of such material and the weight to be attached to it: per Lord Scarman (at 294).”

29.16 *The US considers foreign (tax treaty) jurisprudence*

US courts have considered foreign decisions on several occasions. As indicated in Chapters 17.02 and 29.03, *Pigeon River* adopted a Canadian Supreme Court’s interpretation of the same (non-tax) treaty. However, as one might expect, US courts do not consider foreign decisions with nearly the same frequency as courts in jurisdictions with a similar legal heritage – such as Australia, Canada, New Zealand and the UK.

In US: April 2 1962 *Donroy* (Article 5) Hamlin J. held (301 F.2d 208, footnote 10): “Inasmuch as the phrase “permanent establishment” appears in the Canadian Tax Convention, which is applicable to both Canada and the US, it would be a desirable, although not necessary, result if the courts of each country gave it the same meaning. The decision of the Canadian Tax Appeal Board in ... [Canada: June 3 1959 *No. 630* – Article 5 and see Chapter 29.08] ... and the decision of the US Tax Court in ... [US: August 23 1955 *Johnston* – Article 5] ... indicate that this has been done.” Earlier, Hamlin J. had cited (301 F.2d 207 footnote 8) extracts from the judgment in *No. 630*.

Donroy was cited in LR 83-16-109 and Rev. Rul. 85-60, and was approved in Rev. Rul. 90-80. *Donroy* and Canada: June 3 1959 *No. 630* were both applied (936 F.2d 1320) by Buckley C.J. in US: June 28 1991 *Unger* (all Article 5).

US: May 27 1980 *Riley* (Article 14) involved the residence of a US citizen teaching in Canada. Tannenwald J. referred to six Canadian decisions which also interpreted Article VIII A of the 1942 Canada tax treaty at issue. They indicated that a teacher could be temporarily visiting Canada even if his intentions as to the duration of his stay were of an indefinite nature (which is usually associated with residency).

Tannenwald J. commented (74 T.C. 426): “Decisions subsequent to ... [Canada: May 27 1974 *Stickel* – Article 14] ... confirm our conclusion that the Canadian judicial interpretation of article VIII A looks only to the residence of the taxpayer at the time he enters Canada, and that subsequent facts relating to residence are irrelevant – the only point of dispute seems to be the impact of remaining in Canada *and* engaging in teaching employment after the 2-year period has elapsed. ... [November 9 1977 *Hunt* – Article 14], ... [March 10 1975 *Wyatt* – Article 14], ... [March 11 1975 *Shihadeh* – Article 14]. See also ... [May 1 1975 *Reeder* – Article 15], ... But see ... [January 16 1980 *Erickson* – Article 4] ...”

In US: May 11 1981 *Vetco* Skopil C. J. considered (644 F.2d 1333) Switzerland: *May 16 1975 Bundesgericht* (both Article 26) and other Swiss material.

In US: October 12 1993 *Reuters* (Article 24), involving the 1975 UK tax treaty,

Reuters brought two foreign decisions to the attention of Judge Yesawich in the New York Supreme Court, Appellate Division, Third Department, which his judgment does not identify. Kaplan (one of the attorneys acting for Reuters) has written (1992, 285) that they were France: *November 18 1985 CE* (involving the 1958 Italy tax treaty) and Germany: *March 30 1973 Dusseldorf FG* (involving the 1966 Japan tax treaty) – both Article 24. Reuters and its attorneys used *The International Tax Treaties Service* to research these decisions.

Reuters argued that both these foreign decisions correctly decided that the taxation on a local branch of a foreign corporation shall be not less favourable than that on a local enterprise carrying on the same activities *in that State*.

However, *Reuters* holds that the taxation on a local (New York) branch of a foreign (UK) corporation shall be not less favourable than that on a local enterprise carrying on the same activities *in that State and worldwide*. It holds that the relevant comparison is between a UK corporation with a New York branch and (in Reuters' case) some eighty other branches worldwide, and a US/New York corporation with a New York branch – and also with some eighty other branches worldwide.

Kaplan points out that if *Reuters* is applied at a Federal level (and, as it is the only US decision on this point, it represents US law at present) a foreign entity (such as a bank) with a profitable US branch and unprofitable foreign branches could argue that it can deduct its foreign branch losses from its US branch profits – just as a US corporation with foreign branches can. *Reuters* may offer other US tax planning opportunities – so if the US Supreme Court overturns it, this blessing may be mixed.

Chapter 30 Doctrine

30.01 *The value of doctrine*

Article 38(1)(d) of the Statute of the International Court of Justice runs in part (bold added): “**The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply: ...**

(d) ... the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.”

When a tax treaty is interpreted at a public international level, account must therefore be taken of doctrine. It is a measure of the respect that doctrine commands that it is specifically mentioned as a subsidiary means of determining rules of law – even though it will often post-date the treaty at issue.

In *Fothergill* (see Chapter 3.13) Lord Diplock discussed the value of doctrine. In the House of Lords he commented ([1981] A.C. 283 and 284): “Those commentaries by learned authors on the text of the Convention to which your Lordships have been referred were published after the Convention had been concluded. They did not precede it; the delegates cannot have taken them into account in agreeing on the text. To a court interpreting the Convention subsequent commentaries can have persuasive value only; they do not come into the same authoritative category as that of the institutional writers in Scots law. It may be that greater reliance than is usual in the English courts is placed upon the writings of academic lawyers by courts of other European states where oral argument by counsel plays a relatively minor role in the decision-making process. The persuasive effect of learned commentaries, like the arguments of counsel in an English court, will depend upon the cogency of their reasoning. Those to which your Lordships have been referred contain perhaps rather more assertion than ratiocination, but for the most part support the construction favoured by your Lordships.”

Tax treaty jurisprudence increasingly refers to doctrine, though perhaps not as frequently as authors (or their publishers) might wish. As Boidman forecast (1979, 192): “The general thrust, however, of internationalizing the interpretation of [tax] treaties may lead the courts to consider legal scholarship to an extent which, heretofore, has been totally absent both in the domestic and treaty context.”

Shaw commented (1991, 92): “Because of the lack of supreme authorities and institutions in the international legal order, the responsibility is all the greater upon the publicists of the various nations to inject an element of coherence and order to the subject as well as to question the direction and purpose of the rules.” This comment is particularly apposite in the tax treaty area.

In the discussion on Subject I *Interpretation of double taxation conventions* at the 1993 IFA Congress, Sanford H. Goldberg proposed that articles and other writings of tax advisors and tax professionals should be included in the list of material which Resolution 2 recommended should be considered when interpreting a tax treaty. This list includes jurisprudence and official revenue authority explanations – see Chapter

29.04.

I supported this proposal, but it was not adopted – primarily because it was felt that Resolution 2's main thrust was to recommend the publication of the material it listed. Had more time been available, it would have become more obvious that Resolution 2's main thrust was to recommend what material should be considered – and not what material should be published. Obviously, it is absurd to exclude material from consideration simply because it has already been published. Had more time been available, Resolution 2 could no doubt have been satisfactorily amended so as to incorporate Mr. Goldberg's excellent suggestion that published articles and other writings by tax advisers and tax professionals should be considered.

30.02 *The International Tax Treaties Service has often been referred to and used*

The International Tax Treaties Service has been cited as a reference source in several tax treaty cases. Its thesis, that material on the meaning of terms in one tax treaty is relevant in interpreting identical or similar terms in other tax treaties, was confirmed in India: June 17 1983 *Visakhapatnam* (Article 5) when Jagannadha Rao J. commented (144 ITR 161): "In view of the standard O.E.C.D. models which are being used in various countries, a new area of genuine "international tax law" is now in the process of developing. Any person interpreting a tax treaty must now consider decisions and rulings worldwide relating to similar treaties ..." These words originally appeared in a review of this *Service* by Halpern (1978, 394).

In Australia: August 22 1990 *Thiel* (Article 7) McHugh J. in the Full High Court approved (90 ATC 4,728) of argument based word for word on criticism in *The International Tax Treaties Service* of the two Lower Court decisions. In line with this criticism, the Full High Court unanimously reversed these Lower Courts.

In Canada: March 28 1991 *Utah Mines* (Article 7 and see Chapter 9.17), Walsh D.J. commented (91 DTC 5249) that *The International Tax Treaties Service* contained "interesting" material – namely US: LR 78-44-008 (see Chapter 10.05).

The International Tax Treaties Service was also cited as a reference source by the Attorney-General in Netherlands: *March 14 1979 HR* (Article 4).

In South Africa: November 15 1989 *ITC 1473* Conradie J. cited (52 SATC 131 and 132) *The International Tax Treaties Service* and its *Editorial* – using it to research, and effectively rely upon, Germany: August 21 1970 NR Westphalia Ruling and August 23 1983 Federal Ruling (all Article 14).

The International Tax Treaties Service has frequently been used as a reference source by Counsel, notably in New Zealand: June 14 1990 *JFP Energy* (Article 15) and US: October 12 1993 *Reuters* (Article 24 – see Chapter 29.16).

30.03 *Other citations of (tax treaty) doctrine*

In Australia: August 22 1990 *Thiel* (Article 7) Dawson J. noted (90 ATC 4,723) that although he did not share the doubts correctly expressed by Avery Jones *et al.* (1984, 92) as to whether Article 31(2) of the Vienna Convention permitted a reference to

OECD Commentaries, he did not feel it necessary to decide this issue – because he could just as easily refer to this material under Article 32 (see Chapter 23.15).

In Canada: January 28 1985 *Gladden Estate* (Article 13 and see Chapter 24.01) Addy J. fully agreed with, and adopted (85 DTC 5191), Ward's statement (1977, 264): "... the weight of authority would appear to be against the type of strict interpretation of a tax treaty which would normally be applied to an exempting provision of fiscal legislation." In the Trial Division in Canada: November 8 1993 *Crown Forest* (Article 4) Muldoon J. also referred (92 DTC 6310) to Ward's seminal paper.

In Canada: August 31 1992 *Placrefid* (Article 4) Joyal J. cited (92 DTC 6487) Rivier (1980, 78).

In France: *May 13 1983 CE* (Article 4) Commissaire du Gouvernement Bissara focused on OECD Commentary (see Chapter 26.12) and approved of the view of Koch (1981, 53 onwards) that Courts are generally not bound by competent authority determinations – see Chapter 27.07.

Germany: *April 29 1992 BFH* (Article 26) referred to an argument in Vogel (1990) – see Chapter 26.11.

In Norway: *November 9 1992 Supreme Court* (Article 25) the Norwegian tax authorities also referred to the views of Koch (1981). They concluded (debatably – see Chapter 27.06) that, as a matter of Norwegian law, a competent authority agreement "supplements the treaty itself with the same legal power as the treaty itself."

McNair's *The Law of Treaties* was referred to by A.J. Lloyd Martin (4 NZTC 60,404) in New Zealand: February 19 1979 *Case D1* (Article 25) and by Mummery J. ([1990] STC 301 and 303) in UK: February 9 1990 *Commerzbank* (Article 7).

In South Africa: *May 25 1990 ITC 1503* (Article 8) Melamet J. cited (53 SATC 347) *Passos Tax Treaty Law*, and in South Africa: *March 10 1992 ITC 1544* (Article 24) he cited (54 SATC 463) Vogel (1991).

Switzerland: *September 17 1977 Bundesgericht* (Article 5) considered 1967 IFA Vol. 52b, as well as an article by a Swiss authority, Max Beat Ludwig.

In US: November 1 1946 *Kimball* (Article 18) Arundell J. noted (6 T.C. 538 footnote 4) Mitchell B. Carroll's remark (1935, 588 and see Chapter 7.02) that, as a result of the work of the League and the International Chamber of Commerce committees, "uniform definitions were being formulated, the predominant kinds of income were being classified, and an international tax language was being developed."

In US: *May 27 1980 Filler* (Article 25) Raum J. cited (74 T.C. 410) Patrick (1978A) and Bischel (1978).

In US: *June 28 1991 Unger* (Article 5 and see Chapter 29.16) Buckley C.J. cited (936 F.2d. 1318 and 1320) considerable US doctrine involving partnerships.

In US: *October 12 1993 Reuters* (Article 24 and see Chapter 29.16) Yesawich J. cited (584 N.Y.S. 2d 934) Gifford (1978).

Chapter 31 A summing-up

To sum up: what conclusions have I reached in the preceding pages – and to what extent are these conclusions novel or different?

I have some difficulty in drawing the line between what I regard as self-evident premises – even though no other tax treaty commentator has articulated them hitherto – and what I regard as “my” conclusions. On the basis that what I regard as self-evident premises represent conclusions of mine, then the preceding pages are replete with novel and different conclusions.

31.01 My “two interpretations” approach

Hitherto, the most fundamental debate regarding tax treaty interpretation has been whether a domestic court should interpret a tax treaty primarily by applying principles of public international law – because a tax treaty is a *treaty*, or principles of domestic law – because a tax treaty is also domestic law.

In the second sentence of his General Report on *The interpretation of the double taxation conventions* (see Chapter 1.05) Lenz commented (1960, 294, italics added): “If the meaning of a treaty provision is not clear then *the problem will be solved in the first place by applying the usual rules governing the interpretation of international public law.*” Lenz concluded (1960, 298): “An agreement is thus simultaneously subject to the rules of interpretation applicable to international and domestic public [sic] law, *the rules of public international law taking precedence* in cases of dispute.” He continued (1960, 299): “An international agreement must first of all be interpreted in accordance with the rules of international public law.”

Since 1960, commentators have typically followed Lenz’s view that public international law should generally be applied in priority to domestic law – even when tax treaties are being interpreted, at a domestic level, by domestic courts.

In contrast to Lenz (and his present day followers – whom I call the “Vienna Conventionists”), my most fundamental conclusion, elaborated on in Chapters 1, 2, 14-17, 21, 22, 25, 27 and 28, is that the debate as to whether priority should be given, at a domestic level, to public international law or domestic law is wholly misconceived – because it does not focus sufficiently on the reality that a tax treaty has a dual status. Because it is (at one and the same time) a *treaty* between two States and *domestic law* which must be applied between taxpayers and States, a tax treaty can, and indeed *must*, be interpreted at (a minimum of) two levels. At a public international level, as a treaty between two States, a tax treaty can only be interpreted in accordance with the rules of public international law. At (different) domestic levels, as domestic law in the State where the tax treaty issue has arisen, a tax treaty can only be interpreted in accordance with this State’s domestic law. Such a “two interpretations” approach is wholly novel and original – yet, once articulated, it seems to me (now!) to be self-evident and unassailable.

Inherent in this “two interpretations” approach are the two conclusions (or premises)

that principles of public international law, such as those codified in the Vienna Convention, are (by definition) primarily designed to apply at a public international level – *as between States themselves* – and that, as a matter of domestic constitutional law, the rights of taxpayers at a domestic level can only be determined by domestic law.

Embodying these conclusions (or premises), the very first Article of the Vienna Convention runs: “The present Convention applies to treaties between States.” In relation to this Article 1, Para. 13 of the 1989 OECD *Override* Report (see Chapter 23.10 and Appendix I) comments (italics not added): “13. Under the provisions of Article 1, the Vienna Convention has effect only *between States*. The source for rights and obligations for individuals and organs *within a State* is its domestic law.”

These conclusions (or premises) do not imply an irreconcilable conflict between public international and domestic systems of law – because each system works in a different sphere, wherein each is supreme. Neither system has hegemony over the other; each operates at its own level.

It is, nevertheless, inherent in my “two interpretations” approach that the determination of a tax treaty issue may give conflicting results at a public international level and at a domestic level.

Some, such as Vienna Conventionists, may find these different results so worrying that they will instinctively shy away from the reality that a tax treaty has a dual status – instead of welcoming the implications and benefits of this novel perception. They may therefore persist, just as they have done in the past, in attempts to interpret a tax treaty at a domestic level by giving priority to public international interpretative principles – which they attempt to apply as inflexible rules rather than as adaptable principles.

Because such insensitive attempts ignore both the reality of a tax treaty’s dual status, and the rationales underlying principles of public international law, they are likely to be as unconvincing in the future as they have been in the past.

31.02 My “two interpretations” approach can, surprisingly, be applied consistently

The tax treaty interpreter who adopts (rather than rejects) the “two interpretations” approach, and who sensitively perceives the underlying rationales of the different rules applicable at both public international and domestic levels, is likely to be rewarded. This is because an analysis of the *raison d’être* of the principles applicable at a public international level can clarify which principles should apply at a domestic level. In many cases, the appropriate principles at a domestic level will simply be analogous, domesticated versions of the principles applicable under public international law. Such an analysis can also clarify why it may be appropriate – and consistent – for different results to be reached at different levels.

To the “two interpretations” interpreter, it rapidly becomes apparent that conflicting results (which the Vienna Conventionists find so worrying) typically arise not from the application of conflicting principles, but from the application of the *same* principles – albeit, *necessarily*, at two levels. In these cases, such an interpreter will find that he can

apply the same principles at both public international and domestic levels – in a way that is harmoniously consistent and symmetrical, rather than worryingly different.

The interpreter of a tax treaty at a domestic level who seeks to apply principles of international law as adaptable principles, not as inflexible rules, will thus often discover that these principles, once adapted or “domesticated”, can be unexpectedly useful and relevant at a domestic level – where the appropriate interpretative process will become much clearer.

For example, it is accepted that a State can only be bound (*vis-à-vis* other States) by material of which it could have been aware – see Chapter 21.03. The fact that a State is bound (at a public international level) by material of which it is aware does not mean that this same material should bind (at a domestic level) a taxpayer who could not have been aware of it (see Chapter 21.04) – for precisely the same reasons that a State is not bound (at a public international level) by material of which it could not have been aware. These different results are consistent – in that they arise through the consistent application (albeit, *necessarily*, at different levels) of analogous principles.

The necessity of “two interpretations”, which is dictated by a tax treaty’s dual status, is thus the gateway through which the tax treaty interpreter must pass – and which will then enable him or her to apply the same (adaptable) principles at different levels. Only if this wholly novel and original “two interpretations” approach is adopted can one begin to analyse the parameters of a reasoned, neutral approach to tax treaty interpretation – which could be applied uniformly by all domestic courts and tax authorities worldwide.

31.03 *Public international law should not necessarily have priority at a domestic level*

I accordingly conclude that rules of public international law should not necessarily take precedence at a domestic level – where the application of some of them may be quite inappropriate – and that the proper approach in a domestic context cannot, therefore, be the mirror image of the Vienna Convention approach.

31.04 *Two scenarios illustrating the “two interpretations” approach*

Two scenarios illustrating the “two interpretations” approach may, at this stage, be helpful – to ram home its applicability and efficacy. Both scenarios predicate that the competent authorities of States A and B agree that the allocation of profit on a particular transaction should be 50% to State A and 50% to State B – and that this is a “correct” interpretation of the State A/State B tax treaty.

In the first scenario, the domestic courts of State A hold (“incorrectly”) that, under this tax treaty, the allocation of the profit on such a transaction accruing to a State B resident should be 25% to State A and 75% to State B.

One can readily imagine why, in this first scenario, the tax authorities of State A will be disappointed at this State A decision – and why they will have litigated this issue in the first place. They had agreed with State B’s tax authorities that they (State A) could tax 50% of the profit – yet their own State A court decision has held (“incorrectly”)

that they can only tax 25% of this profit. Inherent in such a decision is a holding that the “50/50 agreement” has no legal force in State A.

This first scenario is unworrying to the interpreter who adopts the “two interpretations” approach.

At a domestic level in State A, as a matter of State A law, even an “incorrect” State A decision must be binding in State A. Indeed, that part of this court’s decision which holds that the competent authorities’ “50/50 agreement” has no legal force should probably be regarded as a courageous (and probably correct) holding that, essentially, a tax treaty cannot impose tax. As Chapter 27.03 comments, it is unlikely, for example, that the UK Parliament (or the US Congress) has delegated any part of its exclusive revenue-raising power to the Crown (or the US President and two-thirds of the US Senate). There are even stronger grounds for arguing that competent authorities cannot impose tax – because it is even more unlikely that, for example, the UK Parliament (or the US Congress) has delegated any part of its exclusive revenue-raising power to unelected civil servants.

At a domestic level in State B, the State B tax authorities will remain free to tax 50% of the profit.

At a public international level, State A is still entitled to tax 50% of the profit – as, indeed, is State B. State A’s inability to collect domestically stems purely from the (“incorrect”) holding by State A’s courts that the tax treaty only permits State A to tax 25% of the profit.

To ensure that the domestic positions in both States A and B match the public international position, State A should therefore pass domestic legislation “overriding” the tax treaty (and the “incorrect” State A decision) so as to achieve a 50/50 allocation. State B should not object to State A passing such legislation – which will merely reflect, possibly retroactively, what the competent authorities had already agreed should be the position.

In the second scenario, the domestic courts of State A hold (equally “incorrectly”) that, under the tax treaty, the allocation of profit on the same transaction accruing to a State B resident should be, not 25% to State A and 75% to State B, but the reverse: 75% to State A and 25% to State B.

Although it is difficult to imagine many State A tax authorities litigating to recover more than they had agreed (with State B) that they are entitled to, such action was arguably taken by Italy in *May 24 1988 CC* (Article 12) – see Chapter 27.14.

Be this as it may, this second scenario is just as unworrying to the interpreter who adopts the “two interpretations” approach as the first scenario.

At a domestic level in State A, it is solely a matter of State A’s domestic (constitutional) law whether State A’s tax authorities are obliged to collect what State A’s courts have held they are entitled to collect – or whether they are entitled to waive this sum, possibly pursuant to a (further) competent authority agreement, so as to ensure that the agreed 50/50 allocation is achieved at a State A domestic level.

If State A’s domestic law does enable its tax authorities to “waive” tax when its

imposition would conflict with a competent authority agreement and/or when this would result in double taxation, so be it – State A’s tax authorities have such a power; if not, so be it (again) – State A’s tax authorities do not have such a power. If State A’s tax authorities do not have such power, State A can easily bring the State A domestic position into line with the public international position by (retroactively) reversing the State A decision and/or by granting its tax authorities the aforementioned power. Needless to say, State B will not object to either or both courses – which can only operate to the advantage of State B residents.

It would, of course, be desirable for State A’s domestic law to endow State A competent authorities with the power to avoid double taxation – so as to enable them to fulfil their tax treaty obligations. Nevertheless, the key point is that the extent of such a power can only be determined, at a domestic level, by State A’s domestic law.

In practice this second scenario is, however, unlikely – for two reasons.

Firstly, State A’s courts will be particularly unlikely to interpret a tax treaty “incorrectly” when this results in State A breaching its international obligations. In many States there is a “presumption of harmony” between domestic law and treaties or agreements between States – and their courts will favour an interpretation that will not result in their own State breaching its international obligations. The (hierarchical) relationship between domestic law and international agreements at a domestic level is, however, primarily a matter of domestic (constitutional) law – an area which falls outside the scope of this thesis, and which merits a separate thesis.

The second reason why this second scenario is unlikely that is it is more than probable that State A’s tax authorities will seek to collect the “additional” 25% that State A’s courts have held they are entitled to collect – because a desire to collect will have been the reason they litigated in the first place.

At a domestic level in State B, the position will depend upon whether the State A tax authorities collect 75% of the profit or not. If they do not, State B will be able to collect its 50% share of the profit without any risk of double taxation. However, if the State A tax authorities do collect 75% of the profit, then the State B resident may well suffer double taxation – because State B’s tax authorities (who will be entitled on a “correct” interpretation of the tax treaty to tax 50% of the profit) may well exercise their entitlement.

Such double taxation is a price that has to be paid by the State B resident – because State A’s courts will, inevitably, uphold such sovereign rights to tax as they decide State A possesses.

At a public international level, in this second scenario, State B may well be aggrieved if State A’s tax authorities do collect the 75% that State A’s courts have (“incorrectly”) held they are entitled to collect. If so, its remedies (such as they are – see Chapter 2.01) lie solely at a public international level.

However, any “harm” done to State B – *and* any harm done to the State B resident at a domestic level – can also be easily remedied at a public international level, as outlined in the next paragraph.

If State A does wish to remedy State B's grievance (essentially, the double taxation of the State B resident) it can do so with ease – by simply writing a cheque to State B for the amount of the tax it has “incorrectly” collected. To avoid the State B resident suffering double taxation (at a domestic level), and to ensure that the domestic positions in both States A and B match the public international position, State B could then simply remit the proceeds of this cheque to the State B resident.

If State A does not wish to remedy State B's grievance, and avoid the double taxation of the State B resident, State B will have to bear this with such fortitude as it can muster – and/or take such retaliatory measures as it feels appropriate.

31.05 *A textual, and contextual, approach should be adopted*

To move on: what other conclusions have I reached in the preceding pages – and to what extent are these other conclusions novel or different? Throughout this thesis I have sought (in far greater depth than anyone else so far) to harmonise, to the extent possible, the different approaches to tax treaty interpretation applicable at a public international level and at (different States') domestic levels. I have explained above that such harmony can (only) be achieved at a domestic level by applying rules of public international law, such as those embodied in the Vienna Convention, as principles which can be usefully adapted – rather than as inflexible rules which, at a domestic level, all too often conflict with domestic law.

One conclusion I draw from my analysis of the relevance of Vienna Convention's principles at a domestic level is that there are good grounds for adopting its textual approach, endorsed as the starting point of interpretation at a public international level by its Article 31(1), as the starting point of interpretation at a domestic level. Any other starting point, such as one based on the supposed “intentions of the parties” or on the supposed “aims and objects” of the treaty (see Chapter 3), is more likely to lead to inconsistencies – as Chapters 4-6 make clear.

Another conclusion which I draw from my perception of the Vienna Convention's limited role at a domestic level is that debates as to whether tax treaty terms (such as “context” – see Chapter 7.06) should be given a specific “Vienna Convention” meaning will always be fundamentally misconceived – because the Vienna Convention was only ever designed to apply *as between States* at a public international level. When these debates involve terms which long pre-date the Vienna Convention they are, furthermore, academic – at best.

In Chapter 7 I also draw the conclusion (which some commentators have yet to articulate explicitly and clearly) that, in interpreting the meaning of tax treaty terms, Article 3 of the OECD Model lays down no sequence which must be followed in deciding whether an Article 3(1) treaty (or Article 3(2) domestic) meaning must be applied – or whether the context requires the application of a contextual meaning.

I recommend a contextual approach – and conclude, in common with Katz (1993, 650; see Chapter 7.10): “There is no question of whether contextual interpretation is preferred to [Article 3(2)] domestic [, or Article 3(1) treaty, definitions]. The very

concept of context implies that it must be.”

Chapter 8 elaborates on the inter-relationship (and possible conflict) between the ordinary meaning of tax treaty terms and domestic laws. It gives guidance as to when domestic definitions are to be encouraged and, less evidently and by reference to novel case studies, discouraged. I give four reasons why references to domestic law should be discouraged. Firstly, one State’s domestic law is, by definition, unilateral – and a bilateral tax treaty term should be interpreted in accordance with the common understanding of *both* treaty partner States (see Chapters 5, 12 and 21). Secondly, any references to domestic law are likely to lead to differing interpretations – because different States’ domestic laws will, typically, differ. Thirdly, references to domestic laws will refer to laws which can change instantly, imperceptibly and with bewildering frequency; such changed domestic laws may well not reflect the common understanding of *both* treaty partner States. Fourthly, some domestic laws may not interface satisfactorily with tax treaties – often as a result of their wholly different domestic, rather than international, provenance.

My conclusion that references to domestic meanings should be discouraged is wholly consistent with my conclusion that priority should always be given to contextual meanings.

In line with these conclusions, Chapter 18 concludes – again contrary to some commentators – that international tax treaty language is “ordinary” (and not special) language in its international tax treaty context. In such a context, domestic definitions are more likely to be “special” than the international tax language in which tax treaties are expressed.

In another interesting example of a harmonious and consistent approach at both public international and domestic levels, I conclude that a person asserting a “special” meaning (such as a domestic tax meaning in an international tax treaty context) should have the burden of proving such meaning at both levels. This conclusion is wholly consistent with my prior conclusion that a contextual meaning has to prevail over any domestic meaning mandated – *unless the context otherwise requires* – by Article 3(2) of the OECD Model.

31.06 My “evolutionary” approach

Chapters 9 and 10 break wholly new ground – by concluding that the meaning of tax treaty terms should be regarded as “evolutionary”.

My “evolutionary” approach, which is again wholly consistent with my conclusion (in Chapter 7) that a contextual approach should always be favoured, is also wholly consistent with the public international principle of contemporaneity (see Chapter 8.01) – which requires a (tax) treaty term can only be given its original meaning *at the time the tax treaty was originally concluded*.

What more logical starting point can there be? The parties to a treaty are just as unlikely to agree that a (tax) treaty term should be given a former (and, by definition, now outdated) meaning as they are to agree that a (tax) treaty term should be given a

(by definition as yet unknown) future meaning.

Avery Jones *et al.* have commented (1984, 41): “The treaty is easier to apply if one does not have to research what the law on a particular subject was at the date of the treaty ...” Be this as it may, this effort clearly must be made.

Inherent in my “evolutionary” approach is the proposition that the adoption of an original meaning does not inhibit the evolution of international tax language, and does not involve the meaning of a tax treaty’s terms remaining “frozen” or “static” for the duration of its life – because no States ever intend this. Contracting States normally intend the meaning of treaty terms to follow the evolution of the law – and thus themselves evolve.

My “evolutionary” approach, under which the meaning of (tax) treaty terms may evolve, is consistent with the principle of contemporaneity – because, at the time they originally conclude a (tax) treaty, the treaty partner States intend that the meaning of (tax) treaty terms should be capable of evolution. The issue, therefore, is not whether the meaning of a (tax) treaty term *can* evolve – it can, if this reflects the parties’ original intent – but whether the meaning of a (tax) treaty term *has* evolved. Evolution should only be permitted where this is consistent with the *original* shared expectations and intentions of the parties *at the time the treaty was originally concluded*.

My “evolutionary” approach highlights the inadequacies of the rival “static” and “ambulatory” approaches to tax treaty interpretation. The “static” approach is too rigid – because it does not allow tax treaty language to “breathe” and adapt to changing circumstances. The “ambulatory” approach (which will typically involve the excessive application of domestic law) is likely to lead to uncertainty and asymmetry in the interpretation, application and effect of tax treaties.

My “evolutionary” approach is also to be preferred to the so-called “ambulatory ... coupled with limitations” approach – which has hitherto been generally accepted as the least objectionable compromise between the “static” and “ambulatory” approaches. The main reason for preferring my “evolutionary” approach is that it adopts, as the starting point of interpretation, the *original* intentions of both parties rather than a (possibly unilateral) subsequent meaning (which the parties could not have contemplated originally) which is then “coupled with” inherent limitations.

The results under both the “evolutionary” and the “ambulatory ... coupled with limitations” approaches may often be the same – but the “evolutionary” approach is the more logical and, partly as a result, the more elegant.

My “evolutionary” approach thus represents the felicitous application, at a domestic level, of principles of public international law which have long been accepted at a public international level – yet which have been ignored by tax treaty commentators hitherto. The optimist within me hopes that it will silence the long-raging debate between the proponents of all the other less satisfactory approaches – or, at least, introduce a worthwhile new dimension to this debate.

31.07 *Tax treaties cannot be interpreted in the same way as taxing statutes*

Chapter 11 focuses on a tax treaty's "object and purpose" – which dictate that a tax treaty (with its object and purpose of avoiding double taxation) should not be interpreted in precisely the same way as a domestic taxing statute (with its object and purpose of imposing tax). Inherent in this conclusion is the conclusion that a uniform domestic approach cannot be identical to any one particular State's approach to the interpretation of its domestic tax statutes.

31.08 *An autonomous approach to tax treaty interpretation must evolve*

The combination of my conclusion that a uniform domestic approach cannot be identical to any one particular State's approach to the interpretation of its domestic tax statutes, and my prior conclusion that the proper approach at a domestic level cannot be the mirror-image of the public international Vienna Convention approach, inevitably leads to a further conclusion. This is that the proper approach at a domestic level, whilst recognising a tax treaty's dual status, should be independent of any interpretative principles which are appropriate only in a purely public international, or a purely domestic, context. This proper approach should be autonomous.

31.09 *An autonomous approach to a tax treaty interpretation must be neutral*

Chapters 5, 12 and 13 are unusual in that, in some respects for the first time for decades, they focus on the "principles" of reciprocity and equality (possibly of effect). These principles, largely derived from public international law, have inspired another of my conclusions – namely that an autonomous approach to tax treaty interpretation should be neutral (and "reciprocal" or "equal") as between all *equal* States (see Chapter 31.11).

Chapter 13 reaches the novel (and, for taxpayers, disturbing) conclusion that the Exchange of Information Articles in the 1942 and 1980 Canada/US tax treaties have come close to being interpreted to give "Heads the IRS wins, Tails the taxpayer loses" unequal results. Canada: July 4 1991 *Montreal Aluminium* (Article 26; Chapter 13.02) holds that a requesting State can obtain more information internationally than it can obtain domestically. US: October 22 1975 *Burbank* (Article 26; Chapter 13.03) holds that a requested State's law can apply even if it is broader than the requesting State's law. US: March 18 1983 *Manufacturers* and February 28 1989 *Stuart* (both Article 26 and Chapter 13.05) hold that the broader a requesting State's law is, the broader US law can be – with the IRS having a seemingly unlimited discretion whether or not to apply it. Taxpayers beware!

31.10 *Supplementary means of interpretation*

Chapters 21-30 focus on supplementary means of interpretation. In line with my fundamental conclusion that domestic law must govern the interpretation of a tax treaty at a domestic level, and the reality that, under many States' domestic laws, competent authority agreements do not have the force of law, I conclude that the importance

which the Vienna Convention attaches to agreements between States at a public international level should not be replicated at a domestic level. I therefore downgrade a tax treaty's negotiating history, competent authority agreements, and practice between States, to supplementary means of interpretation at a domestic level.

In Chapter 21 I set out five principles which should govern the weight to be given to supplementary means of interpretation at a domestic level – and elaborate on them in Chapters 22-30. These principles, most of which I have arrived at by adapting principles of public international law to a domestic context, are as follows.

Of foremost importance is the good faith principle, enshrined in public international law, which requires a bilateral tax treaty to be interpreted in accordance with the common intention of *both* States (see also Chapters 5 and 12). In a further attempt to harmonise the interpretation of a tax treaty at both public international and domestic levels, I conclude that the application of this principle should influence domestic courts towards giving less weight to a tax treaty's unilateral legislative history than they would do when interpreting a domestic taxing statute.

The next most important principle, the adequate publicity principle, flows from the good faith principle; it postulates that supplementary means of interpretation should not generally be accorded *any* weight, at either a public international or a domestic level, unless they have been sufficiently publicised to those who may be affected by them.

The third principle, that of contemporaneity, recognises that greater weight should normally be given to background or contemporaneous material available to the parties at the time they negotiated a treaty than subsequent material – which, by definition, they could not have been aware of at this time.

The contemporaneity principle is particularly relevant to the weight which should be given to OECD Commentary. Existing OECD Commentary (although not part of the “context” of a treaty as defined by Article 31(2)(b) of the Vienna Convention – contrary to the views of some, see Chapter 23.15) should clearly be accorded great weight as representing the collective views of OECD Member States. I conclude that subsequent OECD Commentary must receive less weight – both because of the contemporaneity principle and because of the risk that subsequent OECD Commentary, drafted essentially by tax authorities, may amount to an attempt to create self-serving retroactive negotiating history – a particularly dangerous (for taxpayers) contradiction in terms.

My two final principles (or, more accurately in these two cases, recommendations) are that tax authorities should be estopped from reneging on bilateral agreements and unilateral rulings – even though they may not have the force of law; furthermore, when this material is issued in anticipation of litigation, it should be given no more weight than any other government argument. These two conclusions are broader than comparable recommendations made in the 1992 ALI Report.

31.11 *All (equal) States should apply a uniform approach to tax treaty interpretation*

The desirability of a common or uniform interpretation of tax treaties has long been

recognised; it is the *raison d'être* of the OECD and UN Commentaries on their Models (see Chapter 23.24).

Chapter 3 illustrates that, in relation to international commercial treaties, UK courts have long recognised that it is only possible to fulfil the principles of reciprocity and equality, which dictate that all States apply a uniform approach to treaty interpretation, if due attention is paid to decisions and doctrine worldwide.

In this regard, the remaining Chapters in *Tax Treaty Interpretation* seem less exceptional today than they would have done had they appeared two decades ago – yet they represent by far the most comprehensive proof of the validity of a comparable conclusion originally pioneered, in 1977, by *The International Tax Treaties Service*. This conclusion is that all decisions and rulings worldwide on a particular tax treaty term are relevant in interpreting an identical or similar term in another tax treaty; furthermore, their study is essential in ensuring uniformity of interpretation worldwide. Only if this is done will an autonomous approach to tax treaty interpretation evolve which is uniform – and neutral between all *equal* States. These Chapters demonstrate that the relevance of all (even foreign!) decisions, rulings and doctrine has become so much more accepted since 1977 that it is now often regarded as self-evident.

31.12 Finally ...

It is possible that my conclusions in *Tax Treaty Interpretation*, at the moment often novel and different, will become so generally accepted that they will also, in common with the conclusion underlying *The International Tax Treaties Service*, be treated as self-evident in due course. Needless to say, I hope this will be the case – if only because this would fulfil my long-standing wish to make some contribution, however modest, to the international tax community of which I am honoured to be a part. However I recognise, such are my limitations as compared with the skills of other commentators, that this hope may be unduly optimistic. But, after all, only an unduly hopeful and optimistic person could have begun (and completed – for the time being!) the long voyage of discovery which has culminated in *Tax Treaty Interpretation*.

Throughout this voyage I have been buoyed up by the support of the loyal subscribers to *The International Tax Treaties Service*. None of the effort which *Tax Treaty Interpretation* has entailed could have been possible without the support of these subscribers – to whom *Tax Treaty Interpretation* is dedicated with heartfelt thanks.

Finally, my warmest thanks to Professor Williams for having supervised this Ph.D., and to Professors Avery Jones and van Raad – whose efficiency and promptness in conducting my oral examination was matched only by the perspicacity and helpfulness of their comments, resulting in this Chapter.

Appendix I The 1989 OECD Override Report

Appendix I consists of a report by the Committee on Fiscal Affairs of the OECD which was originally de-restricted by the Council of the OECD on October 2 1989. Copyright vests in the OECD as the publisher, and the OECD has kindly given permission for this data to be reproduced in the form below. The address of the OECD is 2, Rue André-Pascal, 75775 PARIS CEDEX 16, France.

I. THE PROBLEM

Double taxation agreements (tax treaties) [*Footnote 1*: This note is directed primarily at treaty override in the context of income and corporation taxes but the considerations identified in the note and recommendations to the Council based on them have general application to the taxes and duties covered by the OECD Model Convention on Estates and Inheritances and on Gifts.] are an essential element in facilitating economic relations between States and encouraging flows of capital and labour. They form a firm and reliable basis for tax relations between States. They limit and regulate the taxing jurisdiction of the States entering into them so as to ensure the orderly application of the domestic tax laws of what are often quite different systems. Their importance is underlined by the large numbers that are currently in force and the fact that international organisations and the business community repeatedly recommend the enlargement and improvement of the treaty network.

2. The certainty that tax treaties bring to international tax matters has, in the past few years, been called into question, and to some extent undermined, by the tendency in certain States for domestic legislation to be passed or proposed which may override provisions of tax treaties. In this note, which looks at the consequences of such action by national legislatures, the term "treaty override" refers to a situation where the domestic legislation of a State overrules provisions of either a single treaty or all treaties hitherto having had effect in that State. Legislation may take the form of a provision that treaty provisions are to be disregarded in certain circumstances (e.g. in cases of treaty shopping or other forms of abuse). Legislation can also have the effect of overriding treaties, even where no reference is made in the legislation to treaty provisions as such, because the domestic interpretation of the effect of that legislation in relation to treaty provisions has the same effect in practice. Some hypothetical examples of treaty override are given in Section IV of this note.

3. This note proceeds to analyse treaty override from three different points of view. First, it examines the relevant rules of international and domestic law and the relationship between them. Secondly, it considers the possible legal remedies when override occurs. Thirdly, it analyses different practical cases, including the motivation for treaty override in any given situation. The note then presents the position of the Committee on Fiscal Affairs on the question and makes suggestions for action at the international and domestic levels including ways in which particular situations which States have tried to resolve by treaty override can be dealt with.

4. At the outset, however, the kind of treaty override primarily addressed in this note should be distinguished from other situations, which either involve or are similar to treaty override and may have the same effects. Three of these situations are described below and comments are made on them either below or later in this note.

a) A State may legislate to reverse the effect of a court decision which deviates from the common interpretation, explicitly accepted or tacitly implied by the treaty partners, of a provision based on the text of the treaty. In this case, it is not considered that any injury is done to the basis of international tax relations if the competent legislative and administrative organs of the States concerned are in agreement that the court decision is contrary to their intentions. Indeed it is the Court's decision in the first place which may be seen as overriding the treaty;

b) A State may change the definition of a term used in its domestic legislation which is also used in treaty provisions but which is not specifically defined for the purposes of the treaty. In this case there is no override where the treaty contains a provision essentially similar to that embodied in Article 3, paragraph 2, of the 1977 OECD Model Double Taxation Convention which provides that, as regards the application of a treaty by a Contracting State, any term not defined in the treaty shall, unless the context otherwise requires, have the meaning which it has under the law of that State concerning the taxes to which the treaty applies. It cannot have been contemplated that, having once entered into a treaty, a State would be unable to change the definitions of terms used in its domestic law provided such changes were compatible with the context of the treaty;

c) Finally, newly adopted domestic legislation may be incompatible with a treaty provision, without the competent organs intending, or even being aware of, such an effect.

5. In summary, the type of treaty override primarily addressed in this note is the enactment of domestic legislation intended by the legislature to have effects in clear contradiction to international treaty obligations.

II. THE LEGAL ANALYSIS OF TREATY OVERRIDE

(i) Preliminary remarks

6. The legal effect of a treaty override has to be examined both in the light of international and of domestic law.

7. Under a treaty the Contracting States mutually undertake the obligation to respect and apply the treaty provisions. This is the principle of "pacta sunt servanda". Treaty override implies that a State by legislative action gives preference to domestic law over international law, and thus refuses to fulfil certain obligations arising out of the contractual nexus on grounds that the treaty obligations conflict with domestic law. When a treaty override occurs there is, therefore, a breach of the treaty. It should be noted that a breach of the treaty occurs when the overriding legislation is passed by the legislature and not only when it is applied to actual cases. Any breach of a treaty has an effect on the international relationships of the State concerned with other States, and

the rights and obligations arising out of such action have to be determined under the rules of international law.

(ii) *The obligation to perform treaties under international law*

8. Tax treaties are international agreements concluded between States in written form and governed by international law. The Vienna Convention on the Law of Treaties, which came into force on 27th January 1980, contains the rules applicable to treaties concluded after it came into force between States that are parties to the Convention. As at 31st December 1988, 56 States were parties to it, including the following OECD Member countries: Australia, Austria, Canada, Denmark, Finland, Germany, Greece, Italy, Japan, the Netherlands, New Zealand, Spain, Sweden and the UK. Luxembourg and the US have signed, but not ratified, the Vienna Convention. As concerns States which are not parties to the Vienna Convention, or as concerns treaties concluded before its entry into force, the principles applicable are those of customary international law. However, since most of the principles embodied in the Vienna Convention have been derived from customary international law, it is the principles set out in that Convention to which this note will refer.

9. The obligation “*pacta sunt servanda*” is one of the fundamental, universally recognized principles of the law of treaties, which has been codified in the preamble and in Article 26 of the Vienna Convention, which reads as follows: “Every treaty in force is binding upon the parties to it and must be performed by them in good faith.”

10. “Binding on the parties” means that the treaty is binding on the subject of international law as such, i.e. the State as a whole. It does not matter which organ represented the State when entering into treaty commitments, nor whether the procedure by which the State became bound involved parliamentary approval or not. The State is bound even if its consent in that respect was expressed by an organ beyond its competence or under violation of constitutional procedures, unless this violation was evident to the other parties (cf. Article 46 of the Vienna Convention). It “must be performed in good faith” means that international law requires States to implement the provisions of a treaty. It depends on each individual State, the particularities of its constitutional and legal system, and the nature of the treaty itself how such implementation takes place. International law, however, is not concerned with the ways and means by which performance is obtained, but exclusively with the result.

11. Article 27, stressing that internal law cannot serve as justification for non-compliance with treaty obligations, reiterates a principle which might be seen as already implicit under Article 26. This can apply to the case where national legislative or administrative organs adopt measures contrary to existing treaty obligations. According to Article 27, such internal difficulties or even impossibilities may not be present as a legally valid excuse in relations between States, i.e. under international law.

12. In summary, it can be said that under international law treaties have to be observed by the parties as long as they are valid, and unless they have been formally denounced. Domestic legislation (whether subsequent to signature or otherwise) or

other reasons in no way affect the continuing existence of that international obligation. All other parties to a treaty are entitled to insist on compliance by a party not performing its obligations.

(iii) The rank of treaty obligations under domestic law

13. Under the provisions of Article 1, the Vienna Convention has effect only *between States*. The source for rights and obligations for individuals and organs *within a State* is its domestic law. While Article 27 of the Vienna Convention does not admit provisions of domestic law as an excuse for not complying between States, it implicitly admits that conflicting domestic law may exist. This is in accordance with the main doctrines explaining the relationship between international and domestic law: while the “dualist” doctrine believes that international and domestic law are two completely independent systems, each governing different relations and having different sources, the “moderate monist” doctrine sees international and domestic law as part of one overall system, but admits nevertheless the valid existence of domestic law in conflict with international law.

14. It depends on each State’s legal system how, and at what level, international law (treaties, customary law and general principles) is given effect domestically. The level attributed to treaty obligations, as incorporated in domestic law, determines whether derogations therefrom are unconstitutional or not. In the end, the choice is between giving priority either to a State’s international obligations, or to the sovereignty of decision of a country’s elected representatives. “Treaty override” under domestic law can be automatically avoided if, under a State’s Constitution, a higher value is attributed to a treaty obligation than to domestic law or if a State regards treaty law as “*lex specialis*” to which priority is to be given in domestic law. If treaty obligations are considered as having – at most – the same rank as that of domestic law, they may, within some national legal systems be subject to the rule “*lex posterior derogat legi priori*” (i.e. later law overrides prior law). However, the situation is less simple to determine in practice since this principle applies only when inconsistencies arise between the new law and the prior law, and it is well known that courts are reluctant to construe treaties as inconsistent with domestic law (and vice versa).

15. In this respect, OECD Member countries find themselves in different positions. For example, Article 55 of the French Constitution of 1958 provides that treaties regularly ratified or accepted shall possess, from the moment of publication, superiority over ordinary laws [*Footnote 2: Subject to application by the other Party, as concerns each treaty.*]. A similar principle is embodied in Article 94 of the Dutch Constitution. Here, the treaty obligations prevail, also under domestic law, over any conflicting provisions of prior *and* posterior laws. On the other hand, the US has chosen, in accordance with Article VI, paragraph 2, of its Constitution, to give treaty obligations equal rank with domestic law and thus to make such obligations subject to the “*lex posterior*” rule in the case of irreconcilable conflicts. In the Federal Republic of Germany Article 59, paragraph 2, of the Fundamental Law provides for the transformation of the treaty into domestic law and treaties so transformed normally

have precedence [*sic*] over national law. In the UK domestic legislation implementing treaty obligations is subject to amendment or repeal by later legislation. Under the Constitution of Finland, treaties which may conflict with prior domestic law require approval by Act of Parliament and after such approval will have the same rank as that Act.

16. Mention should also be made in this context of the fact that many OECD Member countries are also member States of the European Community. For them, European Community law adopted on the basis of the EEC Treaty, the ECSC Treaty, the EURATOM Treaty and the other Community treaties occupies a special place in the legal hierarchy. Directly applicable EC provisions are, in effect, law which operates directly in the domestic legal system and overrides conflicting domestic law. It should however be noted that the European Communities themselves, in their regulatory activities, are bound by the rules of international law.

17. If a constitutional system does not exclude the adoption of legislation contrary to the State's international obligations, this does not mean that those international obligations are considered as having no importance. If they have such power, the legislative organs must consider carefully whether or not to exercise it. In some States, the outcome of such reflection may almost always be in favor of respecting those international obligations. In others, legislators may, in occasional cases, consider certain national interests as of such overwhelming importance that the State has no other choice but to override its treaty obligations.

18. In summary, the rank of treaty obligations depends on each State's legal system. The latter may allow for derogation, under domestic law, from those obligations. Such derogation is internally perfectly valid, and binding on a State's organs and citizens. It does not, however alter the obligations of the State towards other States under international law.

(iv) Interpretation and application of treaties

19. [Footnote 3, which gives the text of Article 31 of the Vienna Convention, is omitted.] The rules of interpretation embodied in Article 31 of the Vienna Convention are stated in quite general terms and can be applied only on a case-by-case basis. However, some general remarks are called for:

a) First, Article 31 requires States to interpret treaties in the light of their object and purpose. Tax treaties aim primarily at the avoidance of double taxation and the prevention of fiscal evasion but also have the objective of allocating tax revenues equitably between the two Contracting States. Thus, any interpretation achieving these objectives would be preferable to one leading to double taxation or to an inappropriate double exemption. However, since double taxation is a result of taxation in two States, the interpretation of the treaty on the basis of its object and purpose requires a high degree of co-ordination between the Contracting States;

b) Secondly, the general rule of interpretation should be based on the terms of the treaty in their context. This corresponds to the approach taken in Article 3, paragraph 2, of the OECD Model Convention where the context of the treaty takes precedence

over an interpretation derived from national laws. Interpretation should thus aim at a co-ordinated application in both States in order to avoid double taxation or no taxation;

c) Thirdly, in describing the context, the Vienna Convention refers to agreements, whether prior or subsequent to the treaty, as well as to practices; in the case of tax treaties, these will normally require continuous co-ordination between the tax administrations concerned.

20. All this leads to the conclusion that the interpretative process should, in the case of tax treaties, rely on the co-ordination of approaches by the tax authorities in order to achieve the main objectives, namely the avoidance of double taxation and the prevention of fiscal evasion. For this reason, a mutual agreement procedure between the tax authorities has been incorporated in tax treaties not only to solve specific cases but also to deal with any other difficulties or doubts arising as to the interpretation or application of the treaties [*Footnote 4: See Article 25(3) of the OECD [1977] Model Convention.*]. This does not mean that treaties can be interpreted only by formal mutual agreement procedure or by negotiation, since the decisions of courts clearly have an important part to play. Coordination should nevertheless be regarded as the guiding element in the interpretative process.

III. THE REMEDIES UNDER INTERNATIONAL LAW IN CASE OF NON-COMPLIANCE BY A PARTY WITH ITS TREATY OBLIGATIONS

21. If non-compliance consists in one party enacting legislation violating treaty obligations, international law gives the other party the right to require repeal, or at least, non-application of such legislation. The first step which can and should be taken by an injured party is the filing of an official protest in writing, immediately after the government learns of the possibility of treaty override, to the government of the defaulting party stating the details of the treaty override (i.e., the breach of the treaty) and insisting that it complies with its treaty obligations.

22. If this fails, a remedy for non-compliance – termination for the treaty or suspension of its operation by the other party (parties) as a consequence of the breach – is codified in Article 60 of the Vienna Convention. This Article embodies customary international law and practice. It is to be noted that the Article contains separate provisions relating to a bilateral treaty (paragraph 1) and a multilateral treaty (paragraph 2).

23. It is also important to note that the breach of a treaty by one of the parties must be a “material” one as defined in paragraph 3 of Article 60 i.e. consisting in the violation of a provision essential to the accomplishment of the object or purpose of the treaty. If one party is in breach of the treaty the other party may respond but only in a way which is proportionate to the breach. The Vienna Convention in fact provides for suspension in whole or in part of the treaty, thus offering various possibilities of dealing with a breach. Whether a “treaty override” by domestic legislation constitutes such a “material breach” depends on the circumstances of each case.

24. It should also be noted that the words “to invoke the breach as a ground for

terminating” has been used and not the words “may terminate”. Under the Convention, the injured party must follow the procedures set out in Articles 65 to 68 in order to terminate the treaty.

25. As concerns the overriding party, the so-called “*clausula rebus sic stantibus*” (concept that a fundamental change of circumstances may be invoked as a reason for terminating the treaty) may be mentioned, as it might be relied on in order to justify overriding provisions. This is dealt with in Article 62 of the Vienna Convention. However, it does not justify treaty override as such, in particular not a partial one, but only provides a basis for an extraordinary termination of the treaty as a whole. Treaty override provisions typically do not aim at a complete termination of the tax treaty. On the contrary, they aim at suspending unilaterally the operation of certain treaty provisions in one State while in the other State the treaty would remain applicable in its entirety. Moreover, the “change in circumstances” must be determined from an objective point of view, i.e. a fundamental change of the situation prevailing at the time of conclusion of the treaty, and cannot consist in a mere change of national policy. A treaty override, consequently, cannot normally be justified on the basis of the “*clausula rebus sic stantibus*.”

26. It should be added that the provisions of Article 61, paragraph 2, on supervening impossibility of performance read as follows: “Impossibility of performance may not be invoked by a party as a ground for terminating, withdrawing from, or suspending the operation of a treaty if the impossibility is the result of a breach by that party either of an obligation under the treaty or of any other international obligation owed to any other party to the treaty.”

IV. CASES OF NATIONAL TREATY OVERRIDE

27. It may be useful to give some hypothetical examples to illustrate national overriding legislation. These examples are not intended to reflect specific overriding legislation in Member countries but they may bear some resemblance to actual cases.

CASE 1

28. State A introduces a new withholding tax on specific items of income such as interest or royalties. State A’s tax treaties provide that interest and royalties shall be exempt from tax in the State of source. For internal reasons State A legislates that the new tax will be levied, and that no refund will be provided, notwithstanding its tax treaty obligations to ensure an exemption.

29. This is an outright material breach – not simply because the unilateral action imposes a new tax, but because the effect of the new tax is material – of State A’s contractual obligations which would deeply erode the confidence of the international community in State A’s trustworthiness in fulfilling its obligations and even in concluding treaties.

30. The breach being a material one, the treaty partners of State A would be justified in terminating their tax treaty relationship with State A. However, termination could do even more harm economically and endanger the possibility of finding an acceptable

solution in the future. Any wilful treaty override could thus have very serious implications.

CASE 2

31. State B taxes gains from the alienation of immovable property. Taxpayers have found a way to avoid paying the tax by interposing, in State B, a company between themselves and the property and by selling the shares in the company rather than the immovable property itself. State B cannot tax the gain from the sale of the shares as its tax treaties follow Article 13 of the OECD Model Convention. State B legislates that the sale of shares in any real estate company is deemed to be a sale of immovable property for the purpose of the application of its tax treaties.

32. The effect of such legislation is in contravention of State B's tax treaty obligations, even though the overriding measure is clearly designed to put an end to the improper use of its tax treaties. There may be cases where State B could successfully argue that there is such an improper use and deny the treaty benefits but this must be done under existing rules. This type of case might be the object of a mutual agreement procedure but it might also cause State B to give notice of termination [*Footnote 5: As provided under Article 30 of the OECD [1977] Model Convention.*] of its treaties (at least those with States whose tax laws are such that a double exemption would be achieved).

33. Override of the kind described in paragraph 31 above could justify termination by State B's tax treaty partners under Article 60 of the Vienna Convention. However, as in Case 1, this route may do more harm than good. Partial suspension under that Article (restricted to the provision State B is not respecting) by State B's partners might be an adequate response but it would only leave things as they are. As an alternative, partners of State B could show willingness to solve the problem by an adequate and quick revision of the treaties.

V. THE POSITION OF THE COMMITTEE ON FISCAL AFFAIRS

34. The Committee has considered the arguments that might be put forward to defend the use of overriding legislation and recognized that in a number of cases the legitimacy of the objective pursued – in particular where they aim at counteracting abuse of conventions – is well founded but the Committee remains strongly opposed to overriding legislation. Member countries have so far refrained from taking retaliatory measures (which all agree would not be conducive to better understanding in the international tax field) against overriding legislation but the Committee noted that there is a growing dissatisfaction with the continued use of such legislation which could erode confidence in the international tax treaty network as a whole.

35. The Committee cannot agree that breaches of international obligations freely entered into are the proper ways to modify tax treaty obligations and feels that it is becoming urgent to concentrate on other ways to address the problems that overriding legislation aims at solving.

36. When substantial changes are introduced in domestic legislation (for example

introduction of new withholding taxes or taxes on capital gains or on wealth) it is to be expected that the new domestic policy will be incorporated in the tax treaty policy of the State concerned. If there is a conflict with that State's tax treaty obligations the only internationally acceptable way to remove the conflicting provisions is by negotiating appropriate amendments to its tax treaties, not by way of unilateral overriding legislation.

37. It might be argued that this is a long process and that some treaty partners may refuse to enter into negotiations. The Committee recognizes that treaty negotiations, and renegotiations, are indeed time consuming but this is a factor which is common to all bilateral negotiations where a proper balance of advantage to both sides has to be found. Any unilateral abrogation of specific obligations destroys such balance and must be condemned. The Committee does not subscribe to the argument that Member countries are unwilling to renegotiate tax treaties. A number of factors such as manpower shortages, budget limitations, or even a lack of counter-balancing proposals, might give the appearance of some unwillingness to renegotiate but all Member countries are committed to avoiding double taxation and do so as evidenced by the large number of tax treaties already in force. Such unwillingness could however develop if a State repeatedly does not respect its international obligations as it would be meaningless to agree on changes which may not be respected.

38. Where, in the situation described in paragraph 4 a) above, a court interpretation reverses the intended effect of a specific treaty provision, or where there is abuse of tax treaties, the Committee is of the view that swift action should be taken to redress the situation. This could be achieved through domestic legislation but the State concerned should first ensure that there is a broad consensus that the intended legislation does not injure international tax relations. In the event that there is no such consensus, the Committee considers that only renegotiation of the relevant tax treaties is acceptable. The time consideration referred to above is also relevant in this case but treaty partners are likely to reach agreement more rapidly in this type of situation since the object is essentially to clarify what was already intended.

39. The Committee considers that its Working Party No. 1 on Double Taxation might be used as a forum for early consultations on any effects a Member country feels are improper, for the elaboration of adequate interpretation of the treaties and for securing that there is a broad consensus that intended legislation does not injure international tax relations.

VI. SUGGESTIONS FOR ACTION

(i) The Committee on Fiscal Affairs strongly urges Member countries to avoid any legislation which would constitute a treaty override as defined in section I above;

(ii) The motive for enacting legislation that overrides treaties can be less strong if all countries agree that they will promptly undertake bilateral or multilateral consultations to address problems connected with treaty provisions, whether arising in their own country or raised by countries with which they have tax treaties. Working Party No. 1

of the Committee on Fiscal Affairs is an appropriate forum for facilitating such consultation.

The Committee intends to follow developments closely in domestic legislation [*sic*] of Member countries and publicly and forcefully to condemn any action which would constitute a breach of international obligations, including bringing such situations to the attention of the OECD Council.

Annex A

RECOMMENDATION OF THE COUNCIL concerning Tax Treaty Override (adopted by the Council at its 717th session on 2nd October 1989)

THE COUNCIL,

Having regard to Article 5 b) of the Convention of the Organisation for Economic Co-operation and Development of 14th December 1960;

Having regard to the Recommendation of the Council of 11th April 1977 concerning the avoidance of double taxation [C(77)40 (Final)];

Having regard to the Recommendation of the Council of 3rd June 1982 concerning the avoidance of double taxation with respect to taxes on estates and inheritances and on gifts [C(82)64 (Final)];

Having regard to the report of the Committee on Fiscal Affairs of 29th June 1989 on Tax Treaty Override [DAFFE/CFA/89.13 (2nd Revision)];

Considering that double taxation conventions contribute to the removal of obstacles to the free movement of goods, services, capital and manpower between Member countries of the OECD and that the network of conventions brings certainty into international tax matters;

Considering that such certainty has been called into question, and to some extent undermined, by the enactment of legislation which is intended to nullify unilaterally the application of international treaty obligations;

Considering that bilateral or multilateral consultations are the first course of action in dealing with problems arising from conflicts between domestic legislation and treaty provisions:

I. RECOMMENDS Member countries:

1. To undertake promptly bilateral or multilateral consultations to address problems connected with tax treaty provisions, whether arising in their own country or raised by countries with which they have tax treaties;

2. To avoid enacting legislation which is intended to have effects in clear contradiction to international obligations.

II. INSTRUCTS the Committee on Fiscal Affairs to follow developments in this area and to bring to the attention of the Council any action which would constitute a material breach of Member countries' international treaty obligations.

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Appendix III Decisions and rulings**Part A: Material analysed in *The International Tax Treaties Service***

Note: In Part A, the citation used in *Tax Treaty Interpretation* and in *The International Tax Treaties Service* is followed (in brackets) by the Article in which it is analysed in *The International Tax Treaties Service*, by the original source material reference and then by the Chapters in *Tax Treaty Interpretation* in which this citation appears.

Australia

NOTE: F.C.T. = Federal Commissioner of Taxation

April 12 1957 <i>Case J35</i> (Article 2) No. 3 Taxation Review Board; 9 TBRD 162	10.13
September 10 1968 <i>Emanuel</i> (Article 10) <i>Emanuel v. Commissioner of Taxation of the Commonwealth</i> ; High Court; 42 ALJR 220	11.03
June 5 1969 <i>ES&A Bank</i> (Article 7) <i>The English, Scottish and Australian Bank Limited v. F.C.T.</i> ; High Court; 69 ATC 4,069	11.03
September 20 1977 <i>Sherritt Gordon</i> (Article 12) <i>Sherritt Gordon Mines Limited v. F.C.T.</i> ; Full High Court; 77 ATC 4365	9.13; 10.03; 29.07; 29.08
June 17 1986 IT 2323 (Article 17) Taxation Ruling	28.03
December 18 1987 <i>Case V9</i> (Article 14) Administrative Appeals Tribunal; 88 ATC 149	28.03; 28.20
August 7 1990 <i>Case X69</i> (Article 3) Administrative Appeals Tribunal; 90 ATC 531 ..	26.02
August 22 1990 <i>Thiel</i> (Article 7) <i>Thiel v. F.C.T.</i> ; Full High Court; 90 ATC 4,717; 21 ATR 53	3.03; 3.07; 3.12; 3.13; 7.02; 8.16; 11.02; 20.03; 21.02; 23.15; 23.17; 23.25; 29.07; 29.08; 29.12; 30.02; 30.03
November 28 1991 IT 2660 (Article 12) Taxation Ruling	10.03
January 2 1992 IT 2665 (Article 19) Taxation Ruling	24.07
June 12 1992 <i>Robinson</i> (Article 17) <i>F.C.T. v. Robinson</i> ; Federal Court, Melbourne; 92 ATC 4,424	3.10; 3.12; 3.13; 28.03
June 11 1993 <i>Case 23/93</i> (Article 5) Administrative Appeals Tribunal; 93 ATC 288 ..	7.02; 29.07

Austria

November 8 1990 Ruling (Article 24) Z 04 0101/88-IV/4/90; November 27 1990 Amtsblatt der Österreichischen Finanzverwaltung 291, 228	24.07; 27.23
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Belgium

NOTE: CA = Cour d'Appel; CC = Cour de Cassation

November 14 1961 CC (Article 12) 1964/40 Bulletin des Contributions 772	29.03
October 22 1963 CC (Article 5) 1963 La Revue Fiscale 542	29.10

<i>March 2 1970 Brussels CA</i> (Article 18) 1970/10-12 <i>La Revue Fiscale</i> 609	11.03
<i>October 12 1973 CC</i> (Article 10) 1973/10-12 <i>La Revue Fiscale</i> 472; 1974 <i>Pas. I</i> 159 ..	
.....	26.01
1973 Agreement (Article 15) 14 <i>Bulletin de la Fédération des Entreprises de Belgique</i>	
May 10 1973	27.23
May 12 1982 Reply Kelchtermans (Article 15) Ministerial Reply to Question No. 156	
of Mr. L. Kelchtermans; 1982 House of Representatives Questions and Answers	
1516	27.23
<i>June 29 1982 Antwerp CA</i> (Article 5) 1983 <i>Jurisprudence Fiscale</i> 34	27.12
February 22 1984 Question (Article 18) No. 169; de Clippele; July 1984 <i>Bulletin der</i>	
<i>Belastingen</i> 1790; April 15 1984 <i>Fiskoloog International</i> 4	20.04
<i>October 29 1984 Courtrai Court</i> (Article 26) <i>Beslagrechter</i> ; October 1985 643 <i>Bulletin</i>	
<i>der Belastingen</i> 2291	13.01
<i>February 14 1986 Ghent CA</i> (Article 23) January 1987 <i>Revue Générale de la Fiscalité</i>	
29; May/June 1986 <i>Journal de Droit Fiscal</i> 171	11.03
<i>March 8 1988 Brussels CA</i> (Article 15) No. 88/113; 1988/6 <i>Jurisprudence Fiscale</i> 205;	
678 (December 1988) <i>Bulletin des Contributions</i> 1980	23.16
<i>December 21 1990 CC</i> (Article 21) No. 91/28; 1991/2 <i>Jurisprudence Fiscale</i> (FJF) 61	
.....	10.12

Canada

NOTE: M.N.R. = Minister of National Revenue

November 30 1954 <i>Saunders</i> (Article 19) William Vincent Saunders v. M.N.R.; Tax	
Appeal Board; 11 <i>Tax ABC</i> 399; 54 <i>DTC</i> 524	11.03; 14.01; 29.08
June 8 1955 <i>Nisse</i> (Article 23) Aron Nisse v. M.N.R.; Tax Appeal Board; 13 <i>Tax ABC</i>	
129; 55 <i>DTC</i> 358	28.21
June 3 1959 <i>No. 630</i> (Article 5) No. 630 v. M.N.R.; Tax Appeal Board; 22 <i>Tax ABC</i>	
243; 59 <i>DTC</i> 300	29.08; 29.12; 29.16
May 23 1963 <i>Mathewson</i> (Article 23) Rufus Mathewson v. M.N.R.; Tax Appeal	
Board; 32 <i>Tax ABC</i> 178; 63 <i>DTC</i> 490	12.05; 12.06
January 29 1968 <i>Furness Withy</i> (Article 8) <i>Furness Withy & Company Limited v.</i>	
M.N.R.; Supreme Court; 68 <i>DTC</i> 5033	3.10; 20.04
April 1 1968 <i>Interprovincial</i> (Article 23) <i>Interprovincial Pipe Line Company v.</i>	
M.N.R.; Supreme Court; 68 <i>DTC</i> 5093	9.09
October 7 1968 <i>Snell</i> (Article 23) Joel Snell v. M.N.R.; Tax Appeal Board; [1968] <i>Tax</i>	
<i>ABC</i> 1020; 68 <i>DTC</i> 745	9.09
Canada: February 16 1971 <i>Western Electric</i> (Article 12) <i>Western Electric Company</i>	
<i>Incorporated v. M.N.R.</i> ; Supreme Court; 71 <i>DTC</i> 5068	26.01
February 3 1972 <i>Bowen</i> (Article 14) Glenn Lenn Bowen v. M.N.R.; Tax Review	
Board; [1972] <i>CTC</i> 2174; 72 <i>DTC</i> 1161	28.21
June 19 1972 <i>Tara</i> (Article 5) M.N.R. v. <i>Tara Exploration and Development Company</i>	
<i>Limited</i> ; Supreme Court; [1972] <i>CTC</i> 328; 72 <i>DTC</i> 6288	29.07; 29.08

May 27 1974 <i>Stickel</i> (Article 14) M.N.R. v. Ernest G. Stickel; Supreme Court; [1974] CTC 416; 74 DTC 6268	29.16
February 25 1975 <i>Specht</i> (Article 18) Charles A. Specht v. The Queen; Federal Court–Trial Division; [1975] CTC 126; 75 DTC 5069	7.03
March 10 1975 <i>Wyatt</i> (Article 14) Dr. Henry T. Wyatt v. M.N.R.; Tax Review Board; [1975] CTC 2055; 75 DTC 72.....	29.16
March 11 1975 <i>Shihadeh</i> (Article 14) Dr. Emile S. Shihadeh v. M.N.R.; Tax Review Board; [1975] CTC 2116; 75 DTC 74	28.21; 29.16
May 1 1975 <i>Reeder</i> (Article 15) The Queen v. Kenneth F. Reeder; Federal Court–Trial Division; [1975] CTC 256; 75 DTC 5160	29.16
July 3 1975 <i>Shahmoon</i> (Article 5) Ezra Shahmoon v. M.N.R.; Tax Review Board; [1975] CTC 2361; 1975 DTC 275	9.12; 11.03
March 17 1976 <i>Canadian Pacific</i> (Article 12) Canadian Pacific Limited v. The Queen; Federal Court–Trial Division; [1976] CTC 221; 76 DTC 6120	11.03; 28.04
June 9 1977 <i>Cruickshank</i> (Article 18) The Queen v. John M. Cruickshank; Federal Court–Trial Division; [1977] CTC 344; 77 DTC 5226	11.03; 26.01
November 9 1977 <i>Hunt</i> (Article 14) The Queen v. Russell A. Hunt; Federal Court–Trial Division; [1977] CTC 578; 77 DTC 5405	29.16
January 30 1979 <i>Appleby</i> (Article 18) Peter J. Appleby v. M.N.R.; Tax Review Board; [1979] CTC 2168; 79 DTC 172.....	11.03
March 9 1979 <i>MacMillan Bloedel</i> (Article 11) MacMillan Bloedel Limited v. M.N.R.; Tax Review Board; [1979] CTC 2342; 79 DTC 297	28.03
May 7 1979 <i>Vauban</i> (Article 12) Vauban Productions v. The Queen; Federal Court of Appeal; [1979] CTC 262; 79 DTC 5186	20.04
September 7 1979 <i>Hunter Douglas</i> (Article 10) Hunter Douglas Ltd. v. The Queen Federal Court–Trial Division; [1979] CTC 424; 79 DTC 5340	3.04; 22.06; 26.01; 28.04; 29.06
January 16 1980 <i>Erickson</i> (Article 4) Kurt Erickson v. M.N.R.; Tax Review Board; [1980] CTC 2117; 80 DTC 1118	29.16
March 12 1980 <i>Associates</i> (Article 7) The Queen v. Associates Corporation of North America; Federal Court of Appeal; [1980] CTC 215; 80 DTC 6140.....	9.04; 9.13; 9.14; 9.17; 24.03
April 23 1981 <i>Bank of Nova Scotia</i> (Article 23) The Queen v. Bank of Nova Scotia; Federal Court of Appeal; [1981] CTC 162; 81 DTC 5115	29.08
February 3 1982 <i>Abed</i> (Article 3) John Abed, Sidney Abed and Hannah Abed, Executors of the Estate of Heskell S. Abed, deceased v. The Queen; Federal Court of Appeal; [1982] CTC 115; 82 DTC 6099	9.12
September 28 1982 <i>Melford</i> (Article 7) The Queen v. Melford Developments Inc.; Supreme Court; [1982] CTC 330; 82 DTC 6281	3.04; 7.03; 8.12; 9.04; 9.13; 9.14; 9.17; 10.08; 10.09; 10.10; 11.03; 24.03; 26.15; 29.07; 29.08
January 25 1983 <i>Gadsden</i> (Article 13) Doris Lillian Gadsden v. M.N.R.; Tax Review Board; [1983] CTC 2132; 83 DTC 127	8.17; 9.04; 14.01; 24.02; 24.03

July 12 1983 <i>Placements Serco</i> (Article 13) <i>Placements Serco Ltée v. The Queen</i> ; Federal Court–Trial Division; [1983] CTC 307; 83 DTC 5347 (French); 84 DTC 6098 (English translation)	9.14
November 21 1983 <i>Krafve</i> (Article 13) <i>William C. Krafve v. M.N.R.</i> ; Tax Court; [1984] CTC 2021; 84 DTC 1002	9.15; 9.16
January 26 1984 Agreement (Article 7)	27.25; 27.26; 27.27
January 28 1985 <i>Gladden Estate</i> (Article 13) <i>The Estate of the late John N. Gladden v. The Queen</i> ; Federal Court–Trial Division; [1985] 1 CTC 163; 85 DTC 5188	3.04; 5.02; 9.16; 11.03; 12.06; 24.01; 29.08; 30.03
February 13 1985 <i>Taran Furs</i> (Article 7) <i>Taran Furs Inc. v. M.N.R.</i> ; Tax Court; [1985] 1 CTC 2255; 85 DTC 188	8.09; 26.01; 29.08
October 31 1985 <i>Canada-Israel</i> (Article 23) <i>Canada-Israel Development Ltd. v. M.N.R.</i> ; Tax Court; [1985] 2 CTC 2460; 85 DTC 718	11.03
November 25 1985 <i>Fiebert</i> (Article 5) <i>Murray Fiebert v. M.N.R.</i> ; Tax Court; [1986] 1 CTC 2034; 86 DTC 1017	29.08
December 1 1987 <i>Scott Estate</i> (Article 18) <i>The Estate of Donald A. Scott v. The Queen</i> ; Federal Court–Trial Division; [1988] 1 CTC 45; 88 DTC 6012	11.03
December 14 1987 <i>Chhabra</i> (Article 6) <i>O.M.P. Chhabra v. The Queen</i> ; Federal Court–Trial Division [1988] 1 CTC 84; 88 DTC 6015	8.22, 11.03; 28.04
January 30 1989 IT-173R2 (Article 13)	23.26
March 3 1989 <i>Shere</i> (Article 21) <i>Kenneth A. Shere v. M.N.R.</i> ; Tax Court; [1989] 1 CTC 2286; 89 DTC 201	29.08
June 18 1990 <i>Alberta Gas</i> (Article 4) <i>Alberta Gas Ethylene Company Ltd. v. The Queen</i> ; Federal Court of Appeal; [1990] 2 CTC 171; 90 DTC 6419	8.14
February 18 1991 <i>Wuslich</i> (Article 7) <i>Samuel Wuslich v. M.N.R.</i> ; Tax Court; [1991] 1 CTC 2473; 1991 DTC 704	25.06
April 26 1991 <i>Gu</i> (Article 15) <i>Chung Gu v. M.N.R.</i> ; Tax Court; [1991] 2 CTC 2093; 91 DTC 821	11.03; 20.04; 23.17
July 4 1991 <i>Montreal Aluminium</i> (Article 26) <i>Montreal Aluminium Processing Inc and Philip Klein v. Attorney General of Canada and M.N.R.</i> ; Federal Court–Trial Division; [1991] 2 CTC 70; 91 DTC 5424	13.02; 13.03, 13.04, 13.06
October 23 1991 <i>Hinkley</i> (Article 15) <i>Jeffrey Hinkley v. M.N.R.</i> ; Tax Court; [1991] 2 CTC 2778; 91 DTC 1336	23.25; 29.08
February 19 1992 <i>Utah Mines</i> (Article 7) <i>Utah Mines Limited v. The Queen</i> ; Federal Court of Appeal; [1992] 1 CTC 306; 92 DTC 6194	9.10; 9.17; 10.05; 11.10; 14.01; 25.13; 28.04; 29.08; 30.02
June 5 1992 <i>Hale</i> (Article 15) <i>John Hale v. The Queen</i> ; Federal Court of Appeal; [1992] 2 CTC 379; 92 DTC 6370	8.17; 11.03; 24.02
August 31 1992 <i>Placrefid</i> (Article 4) <i>Placrefid Limited v. The Queen</i> ; Federal Court–Trial Division; [1992] 2 CTC 198; 92 DTC 6480	30.03
October 26 1992 <i>Montreal Aluminium</i> (Article 26) <i>Montreal Aluminium Processing Limited and Philip Klein v Attorney General of Canada and M.N.R.</i> ; Federal	

Court of Appeal; [1992] 2 CTC 358; 92 DTC 6567	13.04; 31.09
November 8 1993 <i>Crown Forest</i> (Article 4) <i>Crown Forest Industries Limited v. The Queen</i> ; Federal Court of Appeal; 94 DTC 6107	7.03; 11.03; 20.04; 23.17, 23.21; 30.03

Ceylon

NOTE: I.R.C. = Inland Revenue Commissioner

April 29 1970 <i>Woodend</i> (Article 24) <i>Woodend (K.V. Ceylon) Rubber and Tea Co. Ltd. v. I.R.C.</i> ; Privy Council; [1971] A.C. 321	3.01; 29.07; 29.08
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Denmark

May 22 1985 <i>Tax Court</i> (Article 2) No. 1985-5-173	27.12
December 18 1992 <i>Supreme Court</i> (Article 7) <i>Hojesteret</i> ; 1993 <i>Tidsskrift for Skatteret</i> No. 7	26.12

France

NOTE: CA = Cour Administrative d'Appel; CC = Cour de Cassation; CE = Conseil d'Etat; TA = Tribunal Administratif; TGI = Tribunal de Grande Instance

February 10 1965 CE (Article 12) No. 59,660	29.03
November 25 1968 CE (Article 21) No. 71.227; B.O.C.D. 1969-11, No. 4399	8.18
March 5 1971 CE (Article 4) No. 76,344	29.11
May 19 1972 CE (Article 4) No. 76,534	28.08
January 26 1974 Reply Bourgeois (Article 4) JO Déb. AN 488, No. 6010	28.08
December 4 1974 CE (Article 4) No. 76.534	28.08; 29.02; 29.11
November 26 1975 CE (Article 7) No. 93,187	8.18; 28.08
April 7 1976 Reply Fritsch (Article 4) No. 24.132; JO Déb. AN 1420	27.23
March 14 1979 CE (Article 4) No. 8.046	24.04; 27.28; 27.29; 28.08; 29.02
June 18 1980 CE/2 (Article 11) No. 20.094	27.06
January 22 1982 Instruction (Article 15) B.O.D.G.I. 14 B-I-82	27.23
February 8 1982 Reply Pericard (Article 24) JO Déb. AN 456	28.07
February 16 1983 CE (Article 7) No. 28.383; 7th and 8th ss	5.02
May 13 1983 CE (Article 4) No. 28.831	26.12; 27.07; 30.03
June 10 1983 CE (Article 4) No. 27.391; 7th and 9th ss	29.02
June 4 1984 Reply Bockel (Article 12) JO Déb. AN 2624	26.13
July 27 1984 CE (Article 21) No. 16.649	28.08
January 17 1985 Paris TGI (Article 2) No. 10669/84	9.10; 24.07
July 3 1985 CE (Article 12) No. 56.091; 7th and 8th ss	8.18
November 18 1985 CE (Article 24) No. 50.643	12.13; 29.16
June 2 1986 CE (Article 25) No. 44.571	26.12
November 7 1986 CE/2 (Article 15) No. 49.708	8.18
December 8 1986 Reply Chartron (Article 11) JO Déb. AN 4709	28.01

<i>January 5 1987 Paris TA</i> (Article 26) 1st Section No. 41.465/83-1	11.05
<i>June 17 1987 CE</i> (Article 25) No. 64.549	28.06
<i>November 24 1987 Reply</i> (Article 9) 1988 Droit Fiscal 1112	26.16
<i>March 3 1988 Instruction</i> (Article 25) B.O.I. 14 B-1-88	28.06
<i>April 12 1988 Paris TA</i> (Article 4) No. 65.447/86-1; 1 ^a Section 1 ^a Chamber	27.12
<i>May 9 1988 Reply Bachelet</i> (Article 4) JO Déb. AN No. 31.832, 1966	27.23
<i>July 8 1988 CE</i> (Article 17) No. 60.731, 7th and 9th ss	27.12
<i>August 3 1988 Nice TA</i> (Article 24) No. 897/88/III	28.07
<i>January 19 1989 Reply d'Ornano</i> (Article 4) JO Déb. Sénat No. 2289, 82	27.23
<i>June 20 1989 CC</i> (Article 24) Nos. 87-15.803-16.732-19.732 and Nos. 88-10.792-11.852	11.04
<i>February 16 1990 CE</i> (Article 24) Nos. 68.627, 68.628; 9th and 8th ss	21.04; 27.12
<i>April 25 1990 Lyon CA</i> (Article 9) Nos. 86-9508 and 86-10150	26.16
<i>December 21 1990 CC</i> (Article 24) Assemblée plénière; No. 322 P	24.07; 26.01
<i>April 16 1991 Lyon CAA</i> (Article 25) No. 89-1492	28.06; 28.07
<i>November 29 1991 Reply Charie</i> (Article 24) JO Déb. AN 6782	24.07
<i>January 15 1992 CE</i> (Article 10) No. 111379; 7th and 8th ss	11.03
<i>March 24 1992 CC</i> (Article 2) No. 572 P	24.07; 28.07
<i>May 14 1992 Reply de Cuttoli</i> (Article 1) JO Déb. Sénat 1124	27.23
<i>April 16 1992 Lyon CAA</i> (Article 26) No. 90.599	11.05
<i>November 12 1992 Paris CAA</i> (Article 7) No. 90.556	26.01
<i>March 4 1993 Reply de Cuttoli</i> ((Article 13) Sénat; 377; No. 24069	5.02; 12.06

Germany

NOTE: BFH = Bundesfinanzhof; FG = Finanzgericht

<i>August 27 1965 Correspondence</i> (Article 12)	27.13
<i>February 26 1969 Hamburg Ruling</i> (Article 8) 52-S 1300 22/67	9.03
<i>January 13 1970 BFH</i> (Article 24) 1970 BStBl II 790	29.12
<i>August 21 1970 NR Westphalia Ruling</i> (Article 14) S 1301-USA 20-VB3, S 1301 Grossbritannien 4-VB3	12.01; 30.02
<i>March 10 1971 BFG</i> (Article 29) Bundesverfassungsgericht; Z BvL 3/68; 1971 BStBl II 645	27.24
<i>July 23 1971 BFH</i> (Article 4) III R 60/70	29.11
<i>March 30 1973 Dusseldorf FG</i> (Article 24) III 136/71; 10 EFG 509	29.16
<i>September 25 1973 Federal Ruling</i> (Article 23) 1973 European Taxation 443	27.23
<i>July 31 1974 BFH</i> (Article 23) I R 27/73	8.22
<i>September 12 1974 Lower Saxony Ruling</i> (Article 23) S 1301-14-332; 45 DB 2136	27.23
<i>February 19 1975 BFH</i> (Article 10) I R 26/73	22.04
<i>April 24 1975 BFH</i> (Article 6) 1975 BStBl II 604	12.06
<i>July 21 1975 NR Westphalia Ruling</i> (Article 23) S 1301 Luxembourg 4 VB 2	27.23

<i>June 10 1976 Rheinland Pfalz FG</i> (Article 14) III 140/74	12.01
<i>February 20 1979 BFH</i> (Article 26) VII 16/78	29.09
<i>April 21 1981 Federal Ruling</i> (Article 15) IV C5 S 1300-171/81	24.06
<i>May 19 1982 BFH</i> (Article 13) I R 257/78; 1982 BStBl II 768	8.06
<i>July 9 1982 Federal Ruling</i> (Article 15) IV C5 S 1301 - Belgien - 51/82	27.23
<i>August 23 1983 Federal Ruling</i> (Article 14) IV - C6 S-1301 - SAF 6/85	30.02
<i>January 23 1985 BFH</i> (Article 5) I R 292/81; 1985 BStBl II 417	23.25
<i>August 9 1985 Hamburg FG</i> (Article 24) II 69/80	26.11
<i>August 21 1985 BFH</i> (Article 15) I R 63/80; 1986 BStBl II 4	20.04
<i>October 9 1985 BFH</i> (Article 7) I R 128/80	1.03; 1.04; 3.05; 6.05; 11.03; 12.07; 17.01; 25.09; 25.12; 26.02; 27.13; 27.17; 29.03; 29.09; 29.15
<i>November 28 1985 Federal Ruling</i> (Article 18) IV-C5 S-1301-USA 373/85	27.22; 27.23
<i>March 5 1986 BFH</i> (Article 4) I R 201/82; 1986 BStBl II 496	5.04
<i>January 20 1988 BFH</i> (Article 26) 1988 BStBl II 412	26.11
<i>January 27 1988 BFH</i> (Article 10) I R 241/83	3.05; 12.07
<i>February 24 1988 BFH</i> (Article 15) I R 143/84; 1988/10 Finanz Rundschau 285	29.12
<i>November 4 1988 Dusseldorf FG</i> (Article 23) 13 K 493/82 BB	23.22
<i>May 10 1989 BFH</i> (Article 15) I R 50/85; 1989 BStBl II 775	20.05; 26.01
<i>December 13 1989 BFH</i> (Article 13) I R 39/87; 1990 BStBl II 379	8.08
<i>July 30 1990 Federal Ruling</i> (Article 15) IV C 5 S 1300-141/90; 1990 BStBl I 314	20.05; 26.01
<i>November 13 1990 BFH</i> (Article 7) VIII R 152/86; 1991 BStBl II 94	23.14
<i>June 4 1991 BFH</i> (Article 10) XR 35/88 1991 Fr 567	8.22
<i>July 4 1991 Lower Saxony FG/I</i> (Article 5) No. VI 480/89; 1991 RIW 1055	23.25
<i>July 31 1991 BFH/I</i> (Article 19) I R 47/90; 1991 Finanz Rundschau 754	23.18
<i>February 26 1992 BFH</i> (Article 7) I R 85/91; 1992 RIW 689	23.25
<i>April 29 1992 BFH</i> (Article 26) I B 12/92; 1992 RIW 604	26.11; 30.03
<i>October 13 1992 Federal Ruling</i> (Article 15) IV C 6-S 1301 Schz 101/92; 1993 RIW 82	27.23
<i>January 20 1993 BFH</i> (Article 7) I R 54/92; 1993 BStBl II 483; 1993 DB 1454	1.03; 1.04; 6.05; 11.03; 17.02; 26.01; 26.02; 27.13; 29.09; 29.15

India

<i>June 17 1983 Visakhapatnam</i> (Article 5) Commissioner of Income-Tax, A.P.-I v. Visakhapatnam Port Trust; Andhra Pradesh High Court; 144 ITR 146	7.02; 29.10; 30.02
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Italy

NOTE: CC = Corte di Cassazione

November 26 1981 Note (Article 17) No. 12/062	9.03
October 17 1983 Rome Commission (Article 23) 1st Grade; Il Fisco/5; April 21 1986	11.03
May 24 1988 CC (Article 12) No. 3610; 1988 Rassegna Tributaria II 967; 1988 Giurisprudenza delle Imposte 74	27.14; 27.29; 31.04

Monaco

October 31 1991 Monaco Tribunal (Article 25) 1st Instance; 1992/1 RJF 39	27.15
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Netherlands

NOTE: GH = Gerechtshof; HR = Hoge Raad

March 2 1965 Ruling (Article 15) No. B4/14537	27.23
May 12 1966 Amsterdam GH (Article 4) No. 647/65	27.06
June 26 1968 HR (Article 23) No. 15,935; BNB 1968/170; 1968 VN 23,487	7.11
February 4 1970 HR (Article 5) No. 16,305; BNB 1970/71; 1970 VN 183; WFR 1970/ 798	20.04
September 16 1975 Ruling (Article 8) No. 07-500078	9.03
March 24 1976 HR (Article 5) No. 17,812	26.13
January 26 1977 HR (Article 18) No. 18,010; BNB 1977/111	11.02; 20.04; 25.02
October 11 1978 HR (Article 11) No. 18,759	23.25
March 14 1979 HR (Article 4) No. 19,112; BNB 1979/117	26.12; 28.05; 29.11; 30.02
June 24 1981 HR (Article 14) No. 20,216; BNB 1981/236; 1981 VN 1382	25.02; 26.01; 26.12
November 23 1983 HR (Article 17) BNB 1984/33	23.25
March 26 1984 The Hague GH (Article 18) (Gerechtshof; BNB 1984/249	26.01; 26.12
May 28 1984 Hertogenbosch GH (Article 6) 1984 VN 2133	11.02
June 14 1985 Ruling (Article 15) No. 085-332, Infobulletin 85/636	27.22
September 18 1985 HR (Article 16) No. 22,926; BNB 1985/333; FED 1985/ 546	9.07
November 22 1985 Amsterdam GH (Article 10) 1986 VN 1439	28.10
May 13 1987 HR (Article 18) No. 24,314; BNB 1987/207; VN July 4 1987	24.07; 26.01
May 20 1987 HR (Article 18) No. 23,792; 1992 VN 39	24.07
November 2 1987 Ruling (Article 18) No. 087/2683; BNB III C No. 366	24.07; 26.01
June 12 1989 Ruling (Article 4) IFZ 89/320; Infobulletin 89/448	26.16
June 28 1989 HR/2 (Article 4) BNB 1990/45	26.12

<i>July 4 1989 HR</i> (Article 18) No. 25,660; FED 1989/635	26.05; 26.12
<i>April 23 1991 Ruling</i> (Article 23) IFZ 90/1733, IFZ 293; FUTD 91-598	24.07
<i>July 3 1991 HR</i> (Article 13) No. 25308; FUTD 91-1031; BNB 1991/248 ...	3.06; 25.02
<i>March 25 1992 Ruling</i> (Article 16) IFZ 92/476; FUTD 92-471	10.12; 27.23
<i>April 15 1992 HR</i> (Article 23) No. 28,217; 1992 VN 1580	20.04
<i>September 2 1992 HR</i> (Article 10) No. 27.252; BNB 1992/379; 1992 VN 3407	3.14; 23.25; 24.02; 26.01; 29.06
<i>November 4 1992 HR</i> (Article 13) 1992 VN 3647	8.08; 23.22; 25.13

New Zealand

NOTE: C.I.R. = Commissioner of Inland Revenue

<i>August 17 1965 Case 5</i> (Article 5) Taxation Board of Review; 3 NZTBR 49	29.08; 29.12
<i>July 16 1973 UDT</i> (Article 24) C.I.R. v. United Dominions Trust Limited; Court of Appeal; 1973 1 NZTC 61,028	3.07; 3.10; 23.25; 29.12
<i>February 19 1979 Case DI</i> (Article 25) Taxation Review Authority; 4 NZTC 60,401 ..	5.01; 30.03
<i>February 13 1987 Case J41</i> (Article 4) Taxation Review Authority; 9 NZTC 1,240	7.03
<i>June 14 1990 JFP Energy</i> (Article 15) C.I.R. v. JFP Energy Incorporated; Court of Appeal, CA 260/89; 12 NZTC 7,176	3.07; 3.10; 7.06; 23.25; 24.06; 25.13; 29.12; 30.02
<i>February 7 1992 Wise</i> (Article 15) Wise v. C.I.R.; High Court, Wellington, M 200/87; 14 NZTC 9,032	7.03; 29.07; 29.12
<i>September 11 1992 Case P72</i> (Article 19) Taxation Review Authority; No. 90/90; 1992 NZTC 4,485	11.02
<i>October 2 1992 Squibb</i> (Article 26) C.I.R. v. ER Squibb & Sons (NZ) Ltd. Court of Appeal; 14 NZTC 9,146	3.07; 11.04; 14.01; 23.25
<i>December 23 1992 Case Q11</i> (Article 18) Taxation Review Authority; Case No. 92/117; 1993 NZTC 5,070; 17 TRNZ 600	12.01; 28.22

Norway

<i>April 18 1972 Ruling</i> (Article 4) 1973 Skatte-Nytt A No. 1 at A73-11	28.05; 29.11
<i>November 9 1992 Supreme Court</i> (Article 25)	26.13; 27.16; 30.03

Rhodesia

<i>August 12 1966 Tetra Pak</i> (Article 7) Commissioner of Taxes v. Aktiebolaget Tetra Pak; High Court, Rhodesia (Appellate Division); 28 SATC 213	7.02; 7.03; 11.03; 29.12
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South Africa

NOTE: S.I.R. = Secretary for Inland Revenue

August 19 1975 <i>Downing</i> (Article 5) <i>Downing v. S.I.R.</i> ; Appellate Division; 37 SATC 249	7.02; 23.25; 29.07; 29.14
November 15 1989 <i>ITC 1473</i> (Article 14) Income Tax Case 1473; Cape Special Court; 52 SATC 128	30.02
May 25 1990 <i>ITC 1503</i> (Article 8) Income Tax Case 1503; Transvaal Special Court; 53 SATC 342	7.03; 26.13; 30.03
March 10 1992 <i>ITC 1544</i> (Article 24) Income Tax Case 1544; Transvaal Special Court; 54 SATC 456	5.02; 23.21; 26.01; 29.14; 30.03

Sweden

NOTE: Regeringsrätten = Supreme Court

November 19 1987 <i>Supreme Court</i> (Article 24); 1987 RD 2225; RÅ 1986/785	26.12
December 23 1987 <i>Supreme Court</i> (Article 13) No. 1169-1987; RÅ 1987 162	5.04; 7.10; 9.01; 10.13; 11.02; 14.01; 19.02; 20.04; 25.02
May 10 1989 <i>Supreme Court</i> (Article 4) RÅ 1989/37; June 1990 European Taxation 167	8.06
October 22 1991 <i>Supreme Court</i> (Article 9) Dom 117-122-1989	26.16

Switzerland

NOTE: TA = Tribunal Administratif

September 12 1945 <i>Zurich Commission</i> (Article 24) ORK; 46 ZBl 522	5.03
December 14 1962 Federal Decree (Article 4)	5.04; 23.18
December 31 1962 Federal Letter (Article 4)	23.18
December 23 1970 <i>Bundesgericht</i> (Article 26) 96-I BGE 737	29.09
May 16 1975 <i>Bundesgericht</i> (Article 26) No. 30 BGE. 101 1 160	29.16
September 17 1977 <i>Bundesgericht</i> (Article 5) 102 ATF 264; 1977/12 La Revue Fiscale 533	23.25; 29.10; 30.03
November 9 1984 <i>Bundesgericht</i> (Article 10) 54 Archives de Droit Fiscal Suisse 64	3.08
October 30 1987 <i>Bundesgericht</i> (Article 23) Der Steuerentscheid 1988 BdBSt A 32 Nr. 2; January 1990 Archives de Droit Fiscal Suisse 351; August 1989 European Taxation 291	26.11; 26.13
May 18 1988 <i>Geneva TA</i> (Article 5) 1989 StE A 31.2 Nr. 1	26.11
May 10 1989 <i>Zurich Commission</i> (Article 15) Bundessteuer-Rekurskommission; 1990 StEA 31.4 Nr. 1	10.13; 20.04; 21.03
June 22 1990 <i>Bundesgericht/1</i> (Article 15) BGE 116 Ib 217	26.11; 27.28
June 22 1990 <i>Bundesgericht/2</i> (Article 4) 1991 StE A 31.4 No. 2	9.01; 23.18

UK

NOTE: I.R.C. = Inland Revenue Commissioners

- July 6 1956 *Ashton* (Article 23) Greig v. Ashton; High Court 36 T.C. 581 29.08
- July 16 1959 *Ostime* (Article 7) Ostime v. Australian Mutual Provident Society; House of Lords; 38 T.C. 492
..... 7.02; 9.01; 10.02; 11.03; 23.25; 26.15; 29.07; 29.10; 29.12; 29.13; 29.14
- December 1 1960 *ICI* (Article 23) Imperial Chemical Industries, Ltd. v. Caro; Court of Appeal; 39 T.C. 374 8.20; 11.03
- March 2 1961 *Collco* (Article 10) I.R.C. v. Collco Dealings, Ltd.; House of Lords; 39 T.C. 509 3.01; 5.04; 16.01; 29.07; 29.08; 29.14
- April 8 1965 *Gollan* (Article 23) Duckering v. Gollan; House of Lords; 42 T.C. 333 ...
..... 11.03
- March 29 1968 *London Produce* (Article 5) Fleming v. London Produce Co., Ltd.; High Court; 44 T.C. 582 8.20; 29.07
- June 23 1972 *Strathalmond* (Article 4) Lord Strathalmond v. I.R.C.; High Court; 48 T.C. 537 6.04; 7.12; 11.03; 12.09; 12.10; 12.11; 12.12
- February 5 1975 *Nothman* (Article 18) Nothman v. Cooper; House of Lords; 50 T.C. 159 8.02
- February 5 1975 *Oppenheimer* (Article 18) Oppenheimer v. Cattermole; House of Lords; 50 T.C. 159 8.02
- March 12 1976 *Avery Jones* (Article 4) Avery Jones (Rowley's Administrator) v. I.R.C.; High Court; 51 T.C. 443 6.02; 6.03; 12.10; 12.11; 12.12
- March 1 1982 *Exxon* (Article 4) I.R.C. v. Exxon Corporation; High Court; 56 T.C. 237 6.04; 7.12; 8.14; 12.11; 12.12
- June 12 1986 *Sun Life* (Article 7) Sun Life Assurance Co. of Canada v. Pearson; Court of Appeal; 59 T.C. 250 23.19; 23.25; 26.12; 26.15; 29.08
- May 19 1989 *Padmore* (Article 3) Padmore v. I.R.C.; Court of Appeal; 62 T.C. 352 ...
..... 11.03; 23.21; 26.01
- December 8 1989 *Vas* (Article 14) I.R.C. v. Vas; High Court 1990 STC 137
..... 20.04; 23.21; 23.25
- February 9 1990 *Commerzbank* (Article 7) I.R.C. v. Commerzbank AG [and Banco do Brasil SA]; High Court; 1990 STC 285 1.04; 3.12; 3.14;
6.05; 8.14; 11.03; 12.07; 12.09; 12.12; 12.13; 21.07; 24.01; 25.09; 25.12; 27.17;
27.18; 29.03; 29.06; 29.09; 29.15; 30.03
- February 20 1990 *Union Texas* (Article 10) Union Texas International Corp v. Critchley; Court of Appeal; 1990 STC 305 6.03
- April 12 1991 *Commerzbank* (Article 24) R. v I.R.C. ex parte Commerzbank AG; High Court; 1991 STC 271 12.13; 23.05; 26.13

US

NOTE: Commissioner = Commissioner of Internal Revenue

November 1 1946 <i>Kimball</i> (Article 18) <i>Kimball v. Commissioner</i> ; Court of Appeals 1st Cir.; 157 F.2d 816	7.03; 23.03; 30.03
May 10 1948 <i>Freudmann</i> (Article 23) <i>Max and Henri Freudmann v. Commissioner</i> ; Tax Court; 10 T.C. 775	9.09; 12.01
March 23 1954 <i>LMN</i> (Article 25) <i>N. V. Levensverzekering-Maatschappij van de Nederlanden v. US</i> ; District Court (Connecticut); 121 F.Supp. 116	11.09; 28.11; 28.16
Rev. Rul. 54-5 (Article 7) 1954-1 C.B. 130	27.23
January 17 1955 <i>Handfield</i> (Article 5) <i>Frank Handfield, v. Commissioner</i> ; Tax Court; 23 T.C. 633	25.13; 29.08
March 25 1955 <i>Lewenhaupt</i> (Article 13) <i>Jan Casimir Lewenhaupt, v. Commissioner</i> , Court of Appeals 9th Circuit; 221 F.2d 227	11.02; 25.09; 28.11; 28.15
August 23 1955 <i>Johnston</i> (Article 5) <i>W. C. Johnston v. Commissioner</i> , 24 T.C. 920	29.08; 29.16
Rev. Rul. 55-532 (Article 23) 1955-2 C.B. 592	10.04
Rev. Rul. 56-164 (Article 14) 1956-1 C.B. 848	24.08; 25.08
Rev. Rul. 56-446 (Article 13) 1956-2 C.B. 1065	8.09
July 8 1957 <i>American Trust</i> (Article 4) <i>American Trust Company, v. James G. Smyth ... and US</i> ; Court of Appeals 9th Circuit; 247 F.2d 149	6.06; 12.01; 12.02; 12.04; 28.14
Rev. Rul. 57-330 (Article 15) 1957-2 C.B. 1013	24.08
April 15 1958 <i>Herbert</i> (Article 5) <i>Elizabeth Herbert v. Commissioner</i> , Tax Court; 30 T.C. 26	29.02
Rev. Rul. 58-247 (Article 13) 1958-1 C.B. 623	8.09
Rev. Rul. 59-56 (Article 1) 1959-1 C.B. 737	24.08
Rev. Rul. 60-313 (Article 14) 1960-2 C.B. 627	24.08
February 21 1962 <i>de Amodio</i> (Article 5) <i>Inez de Amodio and John Amodio v. Commissioner</i> , Court of Appeals 3rd Circuit; 299 F.2d 623	28.13; 29.02
April 2 1962 <i>Donroy</i> (Article 5) <i>Donroy Ltd. et al. v. US</i> ; Court of Appeals 9th Circuit; 301 F.2d 200	29.08; 29.16
January 16 1963 <i>Samann</i> (Article 25) <i>Jules Samann v. Commissioner</i> ; Court of Appeals 4th Circuit; 313 F.2d 461; 63-1 USTC 9254	8.20; 10.11; 11.02; 23.21; 25.10; 28.02; 28.13; 28.14; 28.15
April 29 1963 <i>Maximov</i> (Article 4) <i>Andre Maximov, Trustee, v. US</i> ; Supreme Court; 10 L ed 2d 184	6.06; 6.07; 10.11; 12.01; 12.02; 12.03; 12.04; 25.04
September 2 1964 <i>Johansson</i> (Article 4) <i>Ingemar Johansson, et al. v. US</i> ; Court of Appeals 5th Circuit; 336 F.2d 809	6.06; 11.09
September 29 1965 <i>Simenon</i> (Article 5) <i>Georges Simenon v. Commissioner</i> ; Tax Court; 44 T.C. 820	28.14; 28.15; 29.02
October 18 1965 Memorandum (Article 10) <i>Memorandum of Understanding</i>	27.23
Rev. Rul. 65-4 (Article 18) 1965-1 C.B. 630	27.23
Rev. Rul. 65-263 (Article 5) 1965-2 C.B. 561	24.08

July 22 1966 <i>London Displays</i> (Article 12) <i>London Displays Company N.V. v. Commissioner, Tax Court</i> ; 46 T.C. 511	26.01
Rev. Rul. 66-34 (Article 18) 1966-1 C.B. 22	24.08
July 3 1967 <i>Horst</i> (Article 26) <i>US v. Hendrik van der Horst et al.</i> ; Delaware District Court; 270 F.Supp. 365	11.05
Rev. Rul. 67-143 (Article 10) 1967-1 C.B. 425	27.23
Rev. Rul. 67-321 (Article 5) 1967-2 C.B. 470	24.08
September 12 1968 <i>NCR</i> (Article 23) <i>National Cash Register Co. v. US</i> ; Court of Appeals 6th Circuit; 400 F.2d 820	11.02
Rev. Rul. 69-128 (Article 8) 1969-1 C.B. 376	27.23
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Rev. Rul. 70-382 (Article 14) 1970-2 C.B. 331	24.08
Rev. Rul. 70-614 (Article 24) 1970-2 C.B. 150	25.07
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Rev. Rul. 72-106 (Article 14) 1972-1 C.B. 277	24.08
Rev. Rul. 72-301 (Article 20) 1972-1 C.B. 439	24.08; 25.08
Rev. Rul. 72-330 (Article 24) 1972-2 C.B. 444	24.08; 25.08
Rev. Rul. 72-418 (Article 5) 1972-2 C.B. 661	29.10
Rev. Rul. 72-437 (Article 25) 1972-2 C.B. 660	16.01; 24.08; 25.07; 25.08; 27.09; 27.23
Rev. Rul. 72-460 (Article 18) 1972-2 C.B. 659	24.08
Rev. Rul. 72-598 (Article 24) 1972-2 C.B. 451	24.08
Rev. Rul. 73-278 (Article 12) 1973-1 C.B. 336	28.04
Rev. Rul. 73-419 (Article 12) 1973-2 C.B. 436	7.05
Rev. Rul. 73-606 (Article 14) 1973-2 C.B. 434	24.08
February 20 1974 <i>Suez</i> (Article 3) <i>Compagnie Financiere de Suez et de l'Union Parisienne v. US</i> ; Court of Claims; 492 F.2d 798	11.02
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Rev. Rul. 74-239 (Article 24) 1974-1 C.B. 372	24.08; 25.08
Rev. Rul. 74-330 (Article 17) 1974-2 C.B. 278	7.02; 24.08
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Rev. Rul. 74-541 (Article 12) 1974-2 C.B. 411	7.03
October 22 1975 <i>Burbank</i> (Article 26) <i>US v. A.L. Burbank & Co., Ltd. et al.</i> ; Court of Appeals 2nd Circuit; 525 F.2d 9	5.02; 12.06; 13.02; 13.03; 13.06; 17.02; 25.09; 26.06; 29.02; 31.09
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Rev. Rul. 75-503 (Article 17) 1975-2 C.B. 352	24.08
Rev. Rul. 76-19 (Article 20) 1976-1 C.B. 441	7.03; 24.08
Rev. Rul. 76-121 (Article 18) 1976-1 C.B. 24	24.08
Rev. Rul. 76-170 (Article 11) 1976-1 C.B. 470	27.23
Rev. Rul. 76-568 (Article 8) 1976-2 C.B. 492	9.02; 27.23
January 12 1977 Release IR-733 (Article 7)	17.02; 21.07; 27.13; 27.17; 29.15
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Rev. Rul. 77-289 (Article 20) 1977-2 C.B. 490	27.23
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LR 78-04-086 (Article 14)	24.08
LR 78-06-050 (Article 14)	24.08
LR 78-16-031 (Article 5)	24.08
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March 23 1979 <i>Gilbertson</i> (Article 26) The Queen in right of the Province of British Columbia v. John Raymond Gilbertson et al.; Court of Appeals 9th Circuit; 597 F.2d 1161	11.05; 13.01
Rev. Rul. 79-28 (Article 23) 1979-1 C.B. 457	25.07
Rev. Rul. 79-65 (Article 10) 1979-1 C.B. 458	24.08
Rev. Rul. 79-152 (Article 1) 1979-1 C.B. 237	28.18
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LR 79-07-142 (Article 14)	24.08
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LR 79-13-045 (Article 18)	24.08
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LR 79-52-097 (Article 20)	25.07
February 14 1980 <i>Lincoln First Bank</i> (Article 26) US v. Lincoln First Bank, N.A. and J. Rene Prat; District Court, Southern District of New York; 80-1 USTC 9231, 45 AFTR 2d. PH 80-942	13.02; 13.05; 26.06
May 27 1980 <i>Filler</i> (Article 25) Herbert A. Filler and Ingeborg J. Filler v. Commissioner; Tax Court; 74 T.C. 406	25.09; 27.18; 30.03
May 27 1980 <i>Riley</i> (Article 14) Paul V. Riley, Jr. v. Commissioner; Tax Court; 74 T.C. 414	26.01; 29.02; 29.16
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February 2 1981 <i>Holmstrom</i> (Article 18) Bjorn Holmstrom v. PPG Industries et al.; US District Court, W. D. Pennsylvania; 512 F.Supp. 552	11.02
May 11 1981 <i>Vetco</i> (Article 26) US v. Vetco Inc. et al.; Court of Appeals 9th Circuit; 644 F.2d 1324; 81-1 USTC 9428	11.04; 28.23; 29.16
December 23 1981 <i>Constantine</i> (Article 19) George Constantine v. Commissioner; Tax Court; 43 TCM 158	8.04
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Rev. Rul. 81-303 (Article 3) 1981-2 C.B. 255	10.11; 24.08; 28.18; 29.02
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LR 81-41-108 (Article 11)	25.07
LR 81-47-148 (Article 12)	7.03
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May 5 1982 <i>Great-West</i> (Article 7) The Great-West Life Assurance Company v. US; Court of Claims; 678 F.2d 180	1.04; 6.02; 6.05; 6.06; 6.07; 11.03; 17.02; 24.01; 25.09. 25.12; 27.13; 27.17; 27.18; 29.03; 29.06; 29.08; 29.09; 29.15
August 25 1982 <i>Brown & Williamson</i> (Article 29) Brown & Williamson, Limited v. US; Court of Claims; 688 F.2d 747	12.02; 12.04; 23.21; 26.01; 26.03; 27.24; 28.17
December 15 1982 <i>Bache</i> (Article 26) US v. Bache Halsey Stuart Inc.; US Court of Appeals 2nd Circuit; unreported	13.02
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March 18 1983 <i>Manufacturers</i> (Article 26) USA et al., Plaintiffs-Appellants, v. Manufacturers and Traders Trust Company, Defendant; Court of Appeals 2nd Circuit; 703 F.2d 47;	13.05; 13.06; 31.09
April 11 1983 <i>Burghardt Estate</i> (Article 3) Estate of Charlotte H. Burghardt, Deceased v. Commissioner; Tax Court; 80 T.C. 705; affirmed by the Court of Appeals 3rd Circuit without published opinion – 734 F.2d 3	6.06; 10.11; 23.21; 25.09; 28.18; 29.02
Rev. Rul. 83-11 (Article 20) 1983-1 C.B. 367	24.08
Rev. Rul. 83-144 (Article 24) 1983-2 C.B. 295	7.11; 8.14; 24.08
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October 16 1984 <i>Boulez</i> (Article 12) Pierre Boulez v. Commissioner; Tax Court; 83 T.C. 584	8.13; 8.19; 8.20; 26.14
Rev. Rul. 84-21 (Article 10) 1984-1 C.B. 307	24.08
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August 26 1985 <i>Crow</i> (Article 1) Tedd N. Crow v. Commissioner; Tax Court; 85 T.C. 376	26.01; 28.18
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July 28 1986 <i>Casanova</i> (Article 25) Casanova Company v. Commissioner; Tax Court; 87 T.C. 214	28.06; 28.16; 28.17
December 8 1986 <i>Mudry</i> (Article 3) Louis M. Mudry, as Executor of the Estate of Morton Govern, Deceased v. US; Claims Court; 11 Cl.Ct. 207 (1986)	

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Rev. Rul. 86-145 (Article 15) 1986-2 C.B. 297	23.26
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LR 86-28-071 (Article 14)	24.08
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LR 86-49-036 (Article 14)	24.08
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Notice 87-66 (Article 24) 1987-2 C.B. 376	26.01
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LR 87-09-003 (Article 25)	29.02
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March 17 1988 <i>Xerox</i> (Article 23) <i>Xerox Corporation v. US</i> ; Court of Claims; 14 Cl.Ct 455	22.05; 25.09; 25.10; 25.12; 27.05; 27.11; 27.18; 28.17
LR 88-02-084 (Article 10)	24.08
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LR 88-22-061 (Article 7)	9.03
LR 88-27-018 (Article 20)	24.08
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February 28 1989 <i>Stuart</i> (Article 26) <i>US v. Philip George Stuart, Sr., et al.</i> ; Supreme Court; 103 L Ed 2d 388	6.07; 13.03; 13.05; 13.06; 17.02; 22.02; 22.03; 25.05; 25.09; 25.11; 25.12; 31.09
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Rev. Rul. 90-80 (Article 5) 1990-2 C.B. 170	24.08; 29.02
Rev. Rul. 90-101 (Article 3) 1990-49 I.R.B. 8	10.11; 24.08; 28.18; 29.02
June 28 1991 <i>Unger</i> (Article 5) <i>Robert Unger v. Commissioner</i> ; Court of Appeals, District of Columbia Circuit; 936 F.2d 1316	29.08; 29.16; 30.03
November 27 1991 <i>Panton</i> (Article 26) <i>Donald Emmet Panton v. US</i> ; District Court S.D. Florida; 780 F.Supp. 797	13.02
Rev. Rul. 91-32 (Article 5) 1991-1 C.B. 107	24.08; 29.02
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June 29 1992 <i>Hofstetter</i> (Article 24) Karl Hofstetter v. Commissioner; Tax Court; 98 T.C. 4981	28.23
August 13 1992 <i>Snap-On</i> (Article 23) Snap-On Tools, Inc. v. US; Claims Court; 26 Cl.Ct. 1045; affirmed on April 7 1994 by the Court of Appeals, Federal Circuit; 73 AFTR 2d Par. 94-880	5.02; 6.07; 22.05; 25.12; 27.19; 28.17; 29.03
LR 92-05-005 (Article 10)	24.08
LR 92-24-034 (Article 13)	27.23
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October 12 1993 <i>Reuters</i> (Article 24) (Reuters Limited v. Tax Appeals Tribunal et al.; New York Court of Appeals, 584 NYS2d 932	29.16; 30.02; 30.03
LR 93-06-019 (Article 10)	24.08
LR 93-09-011 (Article 10)	24.08
LR 93-30-006 (Article 10)	25.07
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April 20 1994 <i>Barquero</i> (Article 26) Julio Roberto Zarate Barquero v. US v. International Bank of Commerce; Court of Appeals, Fifth Circuit; AFTR 2d 94-828	13.03; 23.21; 25.09

Part B: Material not analysed in *The International Tax Treaties Service*

NOTE: Abbreviations are explained in Part A in relation to each country.

Australia: <i>Studebaker Corp. v. Commissioner of Taxation (N.S.W.)</i> (1921) 29 C.L.R. 225	29.08
Australia: <i>F.C. of T. v. Austin</i> (1932) 48 C.L.R. 590	29.08
Australia: <i>Commissioner of Taxation (N.S.W.) v. Cam and Sons Ltd.</i> (1936) 4 A.T.D. 32	29.08
Australia: <i>Koitaki Para Rubber Estates Limited v. F.C.T.</i> (1940) 64 C.L.R. 15	29.08
Australia: <i>The Shipping Corporation of India Ltd. v. Gamlen Chemical Co. (A/Asia) Pty. Ltd.</i> (1980) 147 C.L.R. 142	3.03, 3.12
Australia: <i>Koowarta v. Bjelke-Petersen</i> (1981-1982) 153 C.L.R. 168	3.03
Australia: <i>The Commonwealth of Australia v. The State of Tasmania</i> (1983) 158 C.L.R. 1	3.03
Belgium: <i>November 7 1961 CC 1962 Pariscrisie Belge</i> 281	27.12
Canada: <i>Re Branch Lines, Canadian Pacific Railway Company</i> (1905) 36 SCR 42	9.01
Canada: <i>Attorney-General for Canada v. Attorney-General for Ontario</i> [1937] A.C.	

326	13.04; 15.02
Canada: <i>M.N.R. v. James A. Taylor</i> 1956 Canada Tax Cases 189, 56 DTC 1125	9.12
Canada: <i>US v. Harden</i> 1963 Canada Law Reports 366	13.01
Canada: <i>Lebern Jewellery Co. Ltd. v. M.N.R.</i> [1976] CTC 2422, 76 DTC 1313	8.09
Canada: <i>The Queen v. Morrissey</i> [1989] 1 CTC 235, 89 DTC 5080	25.03
European Court of Human Rights: <i>Golder case</i> (1975) 57 I.L.R. 201	3.03
ECJ: <i>July 13 1993 ECJ Case 330/91</i> ; 1993 BTC 299	12.13; 23.05
France: <i>July 23 1823 CE Veuve Murat</i> ; Recueil 545	28.08
France: <i>August 6 1823 CE Le Corsaire "La Représaille"</i> ; Recueil 558	28.08
France: <i>July 3 1931 CE Karl and Tito Samé</i> ; Lebon 722	28.08
France: <i>July 8 1988 Paris TGI 1988 Droit Fiscal Comm.</i> 460	11.04
France: <i>October 27 1978 CE Section, Debout</i> ; Lebon 395	28.08
France: <i>March 25 1983 CE No. 16.649</i>	28.08
France: <i>June 29 1990 CE No. 78.519</i> ; 1990 Revue de Jurisprudence Fiscale 626	28.09
Greece: <i>Decision No. 2308/1952, Themis</i> (64), p.134 (Supreme Administrative Court)	8.04
Greece: <i>Decision No. 1058/1954, (E.E.N.21)</i> , p.1185 (Supreme Administrative Court)	8.04
ICJ: <i>Competence of the General Assembly for the Admission of a State to the United Nations</i> 1950 I.C.J. 4	4.01
ICJ: <i>Interpretation of Peace Treaties</i> Advisory Opinion 1950 I.C.J. 65 and 221	6.03
ICJ: <i>The Minquiers and Ecrebos Case</i> 1953 I.C.J. 47	9.01
ICJ: <i>The Aegean Sea Continental Shelf Case</i> 1978 I.C.J. 3	9.02
Japan: <i>April 14 1965 Tokyo District Court 11-5 Shomu Geppo</i> 817	20.04; 25.13
Japan: <i>June 11 1982 Tokyo District Court 29-1 Shomu Geppo</i> 144	23.25
Netherlands: <i>November 27 1986 HR (BNB 1986/47)</i>	9.08
PCIJ: <i>Jaworzina case</i> (1923) P.C.I.J., Series B, No. 8, at 37	16.01
NZ: <i>Reckitt and Colman (New Zealand Ltd) v. Taxation Board of Review</i> [1966] NZLR 1032	28.22
NZ: <i>Europa Oil (NZ) Ltd v. C.I.R. (No. 1)</i> [1970] NZLR 321	28.22
NZ: <i>AGH Finance Ltd v. C.I.R.</i> (1982) 5 NZTC 61,189	28.22
NZ: <i>North Island Wholesale Groceries Ltd v. Hewin</i> (1982) 5 NZTC 61,289	28.22
NZ: <i>Lemington Holdings Ltd v. C.I.R. (No 2)</i> (1983) 6 NZTC 61,576	28.22

NZ: <i>CIR v. VH Farnsworth Ltd</i> (1984) 6 NZTC 61,770	28.22
NZ: <i>Challenge Realty Ltd v. C.I.R.</i> (1990) 12 NZTC 7,212	28.22
UK: <i>Sharpe v. Wakefield</i> (1880) 22 Q.B.D. 239 (CA)	9.01
UK: <i>Porter v. Freudenberg</i> [1915] 1 K.B. 857	3.13
UK: <i>Foulsham v. Pickles</i> [1925] A.C. 458	29.08
UK: <i>Whitney v. I.R.C.</i> [1926] A.C. 37; 10 T.C. 88	6.03
UK: <i>Stag Line Ltd v. Foscolo, Mango and Co Ltd.</i> [1932] A.C. 328	3.07; 3.10; 3.11; 3.12; 313; 20.03; 29.12
UK: <i>Bennet v. Marshall</i> [1938] 1 A.E.R. 93	29.08
UK: <i>Eurymedon</i> [1938] 1 A.E.R. 122	29.10
UK: <i>Henriksen v. Grafton Hotel, Ltd.</i> [1942] 2 K.B. 184	29.08
UK: <i>Swedish Central Railway Co. Ltd. v. Thompson</i> [1952] A.C. 495	29.08
UK: <i>Union Corporation, Ltd. v. I.R.C.</i> [1952] 1 A.E.R. 646	29.08
UK: <i>Government of India v. Taylor</i> [1955] 1 A.E.R. 292	11.04
UK: <i>Unit Construction Co. Ltd. v. Bullock</i> [1960] A.C. 351	29.08
UK: <i>Riverstone Meat Co. Pty. Ltd. v. Lancashire Shipping Co. Ltd.</i> [1961] A.C. 807 ..	3.10; 3.11
UK: <i>Salomon v. Commissioners of Customs and Excise</i> [1967] 2 Q. B. 116	3.01; 23.25
UK: <i>Post Office v. Estuary Radio Ltd.</i> [1968] 2 Q.B. 740	3.13
UK: <i>Black-Clawson International Ltd. v. Papierwerke Waldhof-Aschaffenburg A.G.</i> [1975] A.C. 591	22.03
UK: <i>Ulster-Swift Ltd. v. Taunton Meat Haulage Ltd.</i> [1977] 1 W.L.R. 625	29.05
UK: <i>James Buchanan & Co. Ltd v. Babco Forwarding and Shipping (U.K.) Ltd.</i> [1978] A.C. 141	3.10; 3.12; 3.13; 3.14; 20.03; 29.05
UK: <i>Fothergill v. Monarch Airlines</i> [1981] A.C. 251	3.01; 3.03; 3.07; 3.10; 3.12; 3.13; 3.14; 6.04; 15.02; 20.03; 21.02; 22.03, 23.25; 25.02; 27.17; 29.05; 29.06; 29.08; 29.15; 30.01
UK: <i>Yates v. GCA International Ltd.</i> [1991] STC 157	8.22
UK: <i>Pepper v. Hart</i> [1992] STC 898	3.03; 3.15; 22.03; 25.02; 25.03; 25.14
US: <i>The Antelope</i> (1825) 23 U.S. (10 Wheat.) 66	5.02
US: <i>Re Ross</i> (1891) 140 U.S. 543, 35 L.Ed. 581, 11 S.Ct. 897	11.03
US: <i>Rocca v. Thompson</i> (1912) 223 U.S. 317, 56 L.Ed. 453, 32 S.Ct. 207	6.06
US: <i>Jordan v. Tashiro</i> (1928) 278 U.S. 123, 73 L.Ed. 214, 49 S.Ct. 47	5.02; 11.03
US: <i>Brewster v. Gage</i> (1930) 280 U.S. 327, 74 L.Ed. 457, 50 S.Ct. 115	28.15
US: <i>Factor v. Laubenheimer</i> (1933) 290 U.S. 276, 78 L.Ed. 315, 54 S.Ct. 191	6.06, 11.03, 17.02; 28.14
US: <i>Edward D. Utermeyer v. Commissioner</i> (1933) 59 F.2d 1004, Ct. D. 644, C.B. XII-1, 157 affirming (1931) 24 B.T.A. 906, certiorari denied, (1932) 287 U.S.	

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US: <i>Pigeon River Improvement Slide & Boom Co. v. Charles W. Cox, Ltd.</i> (1934) 291 U.S. 138, 78 L.Ed. 695, 54 S.Ct. 361	17.02; 29.03; 29.16
US: <i>Koshland v. Helvering</i> (1936) 298 U.S. 441, 80 L.Ed. 1268, 56 S.Ct. 767	28.12
US: <i>Biddle v. Commissioner</i> (1937) 302 U.S. 573, 82 L.Ed. 431, 58 S.Ct. 379	8.22; 28.17
US: <i>Helvering v. Wilshire Oil Co.</i> (1939) 308 U.S. 90, 84 L.Ed. 101, 60 S.Ct. 18	28.15
US: <i>Choctaw Nation of Indians v. US</i> (1943) 318 U.S. 423, 87 L.Ed.877, 63 S.Ct. 672	28.14
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